SOCIAL CREDITS OR SOCIALISM

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An Analysis of the Douglas Credit Scheme

by

W. R. HISKETT
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WITH A PREFACE BY

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INTRODUCTION

by

HUGH DALTON

A SICK MAN, the more so if his illness is prolonged, turns uneasily on his pillow and hopes for relief, when other methods of treatment seem unavailing, from any new quack cure of which he reads or hears. The illness of our own society, continuing through long years of capitalist depression and chronic unemployment, likewise predisposes its victims to listen to anyone who advertises some simple magic remedy. One of the most persistent of these advertisers is Major Douglas.

The Douglas Credit Scheme has not, and never has had, a great number of supporters. But it has aroused sufficient interest to make its public exposure a task worth undertaking.

Mr. Hiskett, therefore, has done a valuable service in writing this book. He has adopted the useful method of making Major Douglas tell his own story in his own way, by reproducing both his evidence-in-chief before the Macmillan Committee and his answers to questions put to him by members of that body. The impression which this performance creates upon my mind is that of an incurably muddle-headed witness, who has never really thought out either the theoretical or the practical implications

of his proposals, but flounders under cross-examination from one confused evasion to another. I fancy that most readers of this book, even if they start with some degree of sympathy for Major Douglas' ideas, will end by forming a similar impression to my own.

The Macmillan Committee was more fortunate, in securing the presence and personal assistance of Major Douglas, than was another committee, of which I was a member, in 1922. This committee was appointed by the National Executive of the Labour Party to examine and report on the Douglas Credit Scheme. Its Chairman was Mr. Sidney Webb, and its members included, among others, Messrs. G. D. H. Cole, Rhys Davies, Arthur Greenwood, J. A. Hobson, Frank Hodges, R. H. Tawney, and the late Frank Varley. Both Major Douglas and Mr. Orage declined an invitation to give evidence before us, on the ground that the committee contained too many Socialist economists, who might be presumed to be hostile to their ideas. They also complained that, though there were several trade unionists among us, there were no business men.

The committee, none the less, issued a report, which was accepted by the National Executive and published by the Labour Party under the title of *Labour and Social Credit*. Its conclusion, after a careful analysis of the scheme, was that this was "theoretically unsound and unworkable in practice," and that it was "out of harmony with the trend of Labour thought, and indeed fundamentally opposed to the principles for which the Labour Party stands."

Mr. Hiskett has thus chosen a good title for his

book. For it is important to emphasise that Major Douglas is not a Socialist, and that his proposals are to be regarded, not as something which could form part of a Socialist programme, but as an alternative to Socialism as a remedy for present evils. In his book on *Credit Power and Democracy* Major Douglas, indeed, flatly rejects the socialisation of mines and railways, and argues that the private capitalist should " retain all the ordinary privileges of capitalist administration other than price-fixing " (p. 149). Elsewhere in the same book he expresses the opinion that " nationalisation means nothing more than centralised control of credit, the objective for which high finance in every country is striving, with as plausible a motive as, say, the Miners' Federation, and with more technical capacity " (p. 57). It is evident, not only that Major Douglas is not a Socialist, but that he does not understand what Socialism means.

During the past twelve years, since *Labour and Social Credit* was published, Major Douglas seems to have made no significant modification in the form of his proposals, and to have been completely uninfluenced by any criticism. In a rapidly changing world his mind seems to have stood still, deep rooted in his original fallacies.

If I might add one more to the arguments of Mr. Hiskett and other recent critics[1] of the scheme, I

[1] One of the ablest of whom is Mr. E. F. M. Durbin, whose book on *Purchasing Power and Trade Depression* (Cape, 1933) I recommend to any reader who wishes to pursue this subject further. A summary of the argument of this book, together with some positive proposals, is contained in Mr. Durbin's pamphlet on *Socialist Credit Policy* (Gollancz and New Fabian Research Bureau, 1934).

would draw attention to a practical difficulty which has seldom been noticed. The prices of goods, Major Douglas proposes, shall be fixed below their cost of production, and the losses which employers and shareholders would otherwise suffer shall be made good by the issue to them of additional supplies of currency notes. In consequence of this continuous inflation on the one hand, and of the fixed prices on the other, the demand of the public for all goods whose prices are fixed would greatly exceed the available supply. There must, therefore, be either queues day by day outside the shops, with all the irritation and waste of time which this method of shopping entails, or there must be a strict system of rationing for purchasers of every article the price of which is fixed. This also would cause most widespread irritation, and would involve the misdirection, on a gigantic scale, of administrative energy. The Douglas Scheme is not only an intellectual nightmare, but an administrative monstrosity.

But in economics to prove a negative is not enough. Major Douglas' proposals start from a false diagnosis of our economic illness and end with an absurd plan of treatment, which cannot, in practice, be applied and, if it could, would make the patient much worse. We must substitute a true diagnosis, leading up to a curative treatment, to eliminate poverty, together with the more serious instabilities and inequalities, from the economic system. On this task, of which Mr. Hiskett speaks in his final chapter, the Labour Party has been spending much thought and effort. Two of its recent Policy

Pamphlets,[1] *Currency, Banking, and Finance* and *Socialism and the Condition of the People*, deal with the social control of credit, investment and prices, and of the banks and other financial institutions, and propound measures of Socialist reconstruction to which the Labour Party stands committed. Those who desire to contrast Socialist policy with that of Major Douglas may, therefore, readily do so. And Mr. Hiskett has put such enquirers on the right road.

[1] Published by the Labour Party, Transport House, Smith Square, Westminster. I would commend also an excellent pamphlet by Mr. Colin Clark on *The Control of Investment* (Gollancz and New Fabian Research Bureau, 1933).

AUTHOR'S PREFACE

In re-reading the manuscript of this book I have had in mind a possible criticism—that it is over-weighted by the reproduction of Major Douglas, evidence before the Macmillan Committee, and by the chapter on "First Principles."

Although it must be admitted there is some danger of tiring the patience of a busy reader, I have not thought it wise to make any excisions from the book.

The inclusion of the evidence was part of a general plan, and once I had embarked on an attempt to convict Major Douglas out of his own mouth, any attempt to condense his statement, or make selections from it, was open to objection. With the exception of a brief autobiographical introduction, therefore, the whole of Major Douglas' oral evidence is given exactly as it appears in the official minutes.

If the reader finds it necessary to shorten his perusal of the book, he may treat this as a reference section and omit the chapter entirely, without loss of continuity, although he is urged to read it in detail if possible.

Similarly, Chapter V on "First Principles" may be omitted without weakening the main argument. It is intended primarily for the use of readers having only a slight acquaintance with economic science, and will, I think, assist them to place the problem in a right perspective.

St. Albans.

June, 1934.

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CHAPTER I

INTRODUCTORY

At a time when many institutions are needing overhaul, and many minds are turned in the direction of new ideas and new methods, any constructive proposal designed to meet a pressing need deserves careful consideration. Yet such a proposal must be prepared to face the minutest examination, and the severest criticism, so long as the criticism is fair and unprejudiced and based firmly on fact.

Intelligent criticism is, indeed, the most effective safeguard against ill-considered and unwise experiments. The need for change and reorganisation brings inevitably a spate of schemes, some sound, some doubtful, and some demonstrably fallacious, and it may be dangerously easy to obtain a considerable amount of public support for an ill-conceived plan if it is plausibly presented, and if it coincides, even superficially, with some trend of public opinion. Support which might be mobilised for sound constructive proposals may be dissipated if the field is occupied by alternatives which have no substantial justification.

It becomes, therefore, if not a public duty, at least a public service, to throw the strongest light of criticism upon a proposal or policy which can be shown

to be unwarrantably occupying public attention, to the detriment of sounder and more practical schemes. In the opinion of the writer, such a case can be made out against the Credit proposals associated with the name of Major C. H. Douglas.

Major Douglas first gave public expression to his views in a number of articles written soon after the War, and the theory then put forward was elaborated, first in *Economic Democracy* by C. H. Douglas, and a little later in *Credit-Power and Democracy* by C. H. Douglas and A. R. Orage. Both of these volumes were published in the year 1920, and since then much attention has been directed toward the theory of Social Credit therein propounded, and a considerable amount of public support has been attracted to it. In May of 1930 Major Douglas gave evidence before the Macmillan Committee on Finance and Industry, and more recently, the intensification of the economic blizzard has given to his proposals the greater prominence which any attractively presented policy assumes in a setting of national gloom and disaster.

These proposals, originated more than ten years ago, have been critically examined on numerous occasions, and frequently the criticism has been of an extremely destructive character. Yet it would appear that, although the Douglas Credit Scheme can be shown to be completely fallacious, the attacks which have been levelled at it have somehow failed to demonstrate the fact in such a fashion as to make a permanent impression on the section of the public which is being influenced by the present Social Credit propaganda.

In considering possible methods of presenting, in an easily understandable form, a critical analysis of these proposals, it has seemed that the most useful method would be to reproduce in full the oral evidence given by Major Douglas before the Macmillan Committee, together with the questions addressed to him, and then to submit that evidence to a careful examination.

It may reasonably be assumed that evidence given before a Royal Commission would be carefully prepared and considered, and would represent the most authoritative statement of the case which could be obtained. If it can be shown therefore that the evidence was inaccurate, contradictory, and entirely inconclusive, the reader may draw his own conclusions as to the validity of the contentions which the witness sought to establish.

Accordingly, this evidence and its analysis form a substantial part of the present volume, and it is hoped that the method of treatment, though unconventional, may be more interesting and more easily followed than might have been the case with a more orthodox presentation. A short explanatory section, setting out concisely and clearly the main contentions of the Douglas Credit Scheme, precedes the evidence, and the analysis of the latter is followed by a consideration of certain features of the monetary problem which have been the subject of a great deal of misunderstanding. Finally, the writer has tried to indicate certain defects which Major Douglas' propaganda may have helped to demonstrate, and to suggest the appropriate remedy.

CHAPTER II

EXPLANATORY

THE GENESIS of the Douglas Credit Scheme may be found in the fact that Major Douglas is very strongly impressed by the tremendous potential capacity of industry to produce goods in excess of the present capacity of the economic system to distribute them. As an engineer he naturally, and quite rightly, deplores such a waste of capacity, and he sees clearly that the problem is entirely one of organisation.

The real imperative need of mankind is for goods, coupled with the leisure to use and enjoy them. Money is obviously no more than a convenient token —a means of achieving the distribution of goods amongst the community. If it has ceased to discharge this function it has become an anachronism and should be modified in whatever sense may be necessary, to enable it to perform its proper function.

These are the main considerations which have influenced Major Douglas. The human need for goods is far from being satisfied. The capacity to produce goods in increasing quantities is almost limitless ; possibly even greater than the capacity to consume them. Only the failure of the medium of exchange is holding up the process—is sabotaging the machinery of production and defeating the human

demand for goods. Organisation can and must solve the problem. Machines must be organised to supply all the needs of mankind, and the money machine must be made to function so as to distribute all the goods produced.

The motive here is entirely admirable, and the reader will be prepared to sympathise with Major Douglas' aims, and to grant his premises at least to this point. Yet, "the road to Hell is paved with good intentions," and the most impeccable motive, if united to the wrong method, may become debauched and prostituted. It is possible to travel a long way with Major Douglas in his diagnosis, but it is when he commences to prescribe the remedy that the difficulties emerge.

He starts out with the very laudable desire to solve the economic problem, and confer the boon of a satisfied demand upon a community at present hungry for goods, and he proposes to do it without injury to any. He revolts at the crude and immature proposal to take away from superfluity in order to supply the needy. His is a bloodless revolution *par excellence*, for he will shed no drop of wealth in the process of feeding the hungry multitudes.

The secret of how this may be done has been gleaned by Major Douglas in the course of his examination of the present pricing system. This examination shows him that the price of each final product, to the consumer, is the sum of all the various items of cost which have been incurred in the process of its manufacture. These items include all factory charges (such as depreciation of buildings and plant, lighting and power, and cost of raw

materials and semi-manufactures) plus wages, salaries, and profits.

Yet, according to Major Douglas, the public, which has to buy the final product at a cost which contains all the above elements, has only the purchasing-power distributed to it in wages, salaries, and dividends, with which to make the purchase. The factory charges which form the bulk of the cost, have either been distributed in an earlier period and recovered from the consumer in the price of goods then consumed, or are represented by bank credit. In either case he maintains that they are not now in the hands of the public as purchasing-power, and therefore the only available sum is but a fraction of the total cost.

In *Economic Democracy*, page 70, Major Douglas summarises the various considerations which he deduces from the present pricing system, under the following six heads.

"(1) Price cannot normally be less than cost plus profit.

"(2) Cost includes all expenditure on product.

"(3) Therefore, cost involves all expenditure on consumption (food, clothes, housing, etc.), paid for out of wages, salary or dividends as well as all expenditure on factory account, also representing previous consumption.

"(4) Since it includes this expenditure, the portion of the cost represented by this expenditure has already been paid by the recipients of wages, salaries, and dividends.

"(5) These represent the community; therefore, the only distribution of real purchasing power in respect of production over a unit period of time is the surplus wages, salaries and dividends available after all subsistence, expenditure and cost of materials consumed has been deducted. The surplus production, however, includes all this expenditure in cost, and, consequently, in price.

"(6) The only effective demand of the consumer, therefore, is a few per cent of the price value of commodities, and is cash credit. The remainder of the Home effective demand is loan credit, which is controlled by the banker, the financier, and the industrialist, in the interest of production with a financial objective, not in the interest of the ultimate consumer."

It is more than likely that the reader will experience some difficulty with the above summary. It is typical of a great deal of Major Douglas' text, and it would appear that he often finds it impossible to express his views in language which is easily intelligible. The reader should not be intimidated by the obscure phraselogy, however, for the most careful examination of these six points discloses no more than an amplification of the contention that price contains all items of cost, whilst purchasing power in the hands of consumers corresponds only to certain elements in cost, i.e. wages, salaries, and dividends.

The same contention may be found set out, very definitely, in *Credit-Power and Democracy* (pages 21–22)

in the much discussed A and B theorem. In stating it Major Douglas says :

> "A factory or other productive organisation has, besides its economic function as a producer of goods, a purely financial aspect—it may be regarded on the one hand as a device for the distribution of purchasing-power to individuals through the media of wages, salaries, and dividends ; and on the other hand as a manufactory of prices—financial values. From this standpoint its payments may be divided into two groups :
>
> *Group A* : All payments made to individuals (wages, salaries, and dividends).
>
> *Group B* : All payments made to other organisations (raw materials, bank charges, and other external costs).
>
> "Now *the rate of flow of purchasing-power to individuals is represented by A, but since all payments go into prices, the rate of flow of prices cannot be less than A plus B. The product of any factory may be considered as something which the public ought to be able to buy, although in many cases it is an intermediate product of no use to individuals but only to a subsequent manufacture ; but since A will not purchase A plus B, a proportion of the product at least equivalent to B must be distributed by a form of purchasing-power which is not comprised in the descriptions grouped under A.*"

Continuing from here, Major Douglas goes on to stress the point by a most curious illustration which is worth quoting as an instance of the deceptive quality of his reasoning. He says :

> "This somewhat elusive conception, the grasp of which is vital to an understanding of the modern economic problem, may be made a little clearer by considering Labour as an intermediate product, the raw material of further production, which is, of course, the orthodox capitalistic view, and imagining a Labour corporation—for instance, a trade union—as being in a position to make up the costs and consequently the selling price of this commodity on orthodox principles. In this case, using small letters, group *b* would include all the costs of living—i.e., the overhead charges of the men who are the 'machines' for the production of Labour—and group *a* would be their direct remuneration, and the 'factory cost' of the commodity would again be *a plus b*."

Possibly Major Douglas may have seen, in this illustration, some logical justification for adding the wages paid to the goods and services into which they are exchanged, in order to double the Labour charge. Elsewhere he has insisted that money is no more than a token, and has no meaning apart from the fact that it represents a claim on goods or services; yet here we find him adding the token to the real goods, and so doubling the production cost.

Surely the facts are so obvious they hardly need stating. The charge in this instance is simply a quantity of goods which the workmen earn the right to consume, and the money is no more than the measure of that quantity. The proof of this is that the men cannot hold both the money and the goods, but must needs part with the former in order to

obtain the latter. Any individual or corporation selling labour power sells it for the commodities which the agreed remuneration will procure, and the charge on industry in respect of such labour is the total of those commodities expressed in terms of money, and not the commodities plus the money.

Major Douglas has proved nothing in his illustration, therefore, because he has stated the case incorrectly, and it provides no analogy to the pricing system at present in operation, because there, the manufacturing costs which he calls A costs, and the factory charges which he calls B costs, are in respect of quite distinct and separate operations each involving an expenditure of labour.

This contention, that an inherent defect in the pricing system is continually inflating prices beyond the buying capacity of the purchasing public, is fundamental to Major Douglas' case ; and, it should be clearly understood, the shortage of purchasing-power which he assumes is something quite different from the shortage which many people believe to exist, as a consequence of the productive system over-running the monetary system.

Such a shortage is often claimed, very logically, as an argument for a measure of inflation ; or, if the term be preferred, of reflation. It is probable that many people confuse this shortage with that claimed by Major Douglas, and imagine that it proves his case. Nothing could be farther from the truth. Such a deficiency could be corrected quite easily within the present economic system, and it provides no justification for the particular proposals

which Major Douglas advocates. A much wider gap is required to accommodate his theory, and he consequently bases his whole case on the claim that the productive system is issuing, at one and the same time, purchasing-power and prices, and the volume of purchasing-power going out to the public is *always* much less than the volume of prices attached to the goods they are expected to buy.

It is necessary to grasp the fact, quite clearly, that Major Douglas assumes this inherent and continuous deficiency, as the foundation upon which to build his proposals, and if he fails in this first contention his whole case lacks support, and must collapse. His positive proposals are, indeed, the counterpart of the assumption which we have been discussing, and they consist in the distribution, amongst the purchasing public, of a large amount of additional purchasing-power obtained by an issue of new credit. It is claimed that under this proposal the consumer would be assisted, from the credit source, to buy goods which it is impossible for him to buy at present. The credit would cost the consumer nothing, and it would not inflate prices because, according to the argument, it would merely make good an existing deficiency.

If it be true that the present system continually makes up A and B costs into prices, and at the same time only distributes purchasing-power sufficient to cover A, then it follows, logically, that it ought to be possible to devise some method by which the difference could be made good. The method proposed by Major Douglas is to reduce the price charged to the consumer to a figure below cost, so

as to bring it into relation to the amount of purchasing-power which is available.

In other words, the price of an article contains A and B costs ; but as the consumer only holds purchasing-power equal to A, he must be supplied, from another source, with the equivalent of B ; the claim being, that since this arrangement does no more than make good a deficiency, it cannot increase the cost ; and since the deficiency is bound to recur each time prices are made up on present costing methods, every cycle of production will need a similar issue of credit, of sufficient volume to correct this recurring deficiency.

If the reader has grasped the significance of these two contentions, he has a clear conception of what is called the Douglas Credit Scheme. The first claim —that which maintains the existence of an inherent deficiency of purchasing-power—may be viewed as the foundation on which Major Douglas builds ; the second claim, that purchasing-power, in the form of consumers' credits, can be issued to cover the deficiency, is the structure which he builds on this foundation.

CHAPTER III

IN THE WITNESS BOX

ON THE 1ST OF MAY, 1930, Major Clifford Hugh Douglas, M.I.Mech.E., M.I.E.E., appeared before the Macmillan Committee on Finance and Industry, and gave evidence. After Major Douglas, in a brief personal statement, had indicated the factors which led him to his present conclusions, the Chairman of the Committee opened the examination with a reference to the written statement of evidence which had been supplied to them.

4377 (Chairman)

Question : You tell us at the very outset of your statement that in your view the primary cause of the industrial depression and consequent unrest is financial. When you use that general expression do you mean that there is something inherent in our financial system in this country which necessarily leads to unemployment and unrest?

Answer : Yes, that is my view.

4378

Question : Inherent?

Answer : Inherent.

4379

Question : And that is quite irrespective of any special accentuation of those conditions by the War ?

Answer : I have endeavoured to make that rather subtle distinction plain. If I might refer to paragraph 6 of my evidence—it is a slightly subtle distinction. I think of any given volume of production there is only a possible and probably diminishing proportion of that total which can be sold inside a given credit area, but the total volume can be expanded, and the absolute amount of the smaller proportion can be expanded by alternations in financial policy. Have I made that difference clear ?

4380

Question : What I really wanted to get at was this : If there is an inherent defect in our financial or monetary system, that is a defect which has existed certainly 100 years ?

Answer : In an accelerated form, yes.

4381

Question : I quite agree it may become much more accentuated, but if it is inherent in the system, that system has been the monetary system under which we have been living certainly since the Bank Act ?

Answer : Quite.

4382

Question : And in your view has that system been, quite bluntly, wrong from the beginning ?

Answer : Well, I should not, of course, use the word " wrong " in any moral sense.

4383

Question : No, no !
Answer : In an engineering sense.

4384

Question : Inexpedient ?
Answer : Inexpedient ; pragmatically wrong. I should add that the position has been masked, from the fact that you had a small number of industrial or industrialised countries able to export into an undeveloped world, and the fact that you were enabled to dispose of your unsaleable surplus in an undeveloped world enabled you to have a volume of production of which the proportion that you could sell at home was sufficient for the uses of the country.

4385

Question : Is it your view that so long as we were on the up-grade, so long as we were a progressive country, able to produce and dispose of a growing amount of commodities, the defects of the system would not become manifest, but, on the other hand, when the world had more or less reached saturation, then the defects of the system would begin to be felt ? Is that your view ?
Answer : That is my view.

4386

Question : Because, if our financial system has been on a wrong basis for over 100 years, I should have imagined that you would have had progressive unemployment and progressive depression, and

not, as we have had, periods of quite excellent prosperity succeeded by periods of depression. We have had under the present monetary system periods of great prosperity, as you know, as well as periods of depression in the past. How would you account for that?

Answer : In order to give a really useful answer to that I should certainly have to look into a particular period. I think I should probably be able to find a perfectly satisfactory explanation of that.

4387

Question : Perhaps it is too general a question to put to you, but we have already heard much evidence to show that we are at the present moment in a more or less abnormal or exceptional period when our monetary system is being exposed to stress and strain of a kind to which it was never exposed before; that the system is not itself inherently wrong, but that it will not work adequately under the exceptional strain to which it is being exposed at the present time. But your view is that it is inherently wrong?

Answer : It is.

4388

Question : Therefore you would be giving practically the same evidence to us whether there had been a European war or not?

Answer : I think that the booms and slumps to which you refer are the result, broadly speaking, without going into details, of the fact that the improvement in the industrial system, and the rate of

increase of productive capacity in the industrial system, would normally be very much greater than it is if it were not checked by the financial system. There is a sort of pull-and-haul between the industrial system, which wants to get ahead, and the financial system, which perhaps automatically checks it, and, broadly speaking, that is the general explanation of the booms and slumps, without going into specific details.

4389

Question : We have all read your diagnosis of the position, but I confess I should like to take advantage of your being here to-day to hear from you what is your practical remedy. We as a Committee have got to make practical recommendations. If you can imagine yourself in my unhappy position, as the person who is presiding over the body which has to make the recommendations, what would your practical recommendations to the country be to give effect to your view and remedy this inherently wrong system?

Answer : Well I am afraid my training and experience as an engineer makes me want to hedge on that point. I should say that what I should first want to do would be to examine the situation very closely —more closely than in my position I am able to do.

4390

Question : We are in that very process of examining the position, and we would like your help.

Answer : Broadly speaking, I have a very clear idea of what has to be done.

4391

Question : Will you tell us what your clear idea is?

Answer : You have to equate the available purchasing power of the community to the collective prices of the goods for sale.

4392

Question : That is of all the products of industry?

Answer : Yes, of all the products of industry which are available for sale.

4393

Question : An equation involves two things, which have to be related. Which of the two things has to be corrected; is it the purchasing power which is wanting or is it the production which is wanting; which of the two sides of the balance has got to be dealt with?

Answer : Well, there, I think, you get into a technical point, and that is that, if you attempt to leave the collective prices of the goods for sale alone, and proceed to deal with the collective demand by itself, you get into a technical difficulty which is commonly called inflation. That is to say that if you merely have a state of affairs in which by some process, crude or otherwise, you increase the units of money in people's pockets, and you leave everything else untouched, you get a general rise of prices which will defeat the end you have in view. But if you can utilise some mechanism, some existing mechanism, which will enable you to lower prices, and without the results which usually

follow a lowering of prices—that is to say, bankruptcy, lower profits, decreased production, and so forth—if you can lower prices and leave the money in the pockets of the buyer, you will produce exactly the same result of equating the purchasing power to prices without the evils of inflation. That is, broadly speaking, the position which you arrive at.

4394 (Professor Gregory)

Question : How do you propose to do it?

Answer : How do I propose to do it? Well, I should again repeat the *caveat* that I entered first of all, that if I were Dictator I should want to examine the situation a little more closely, but it is quite possible to use the powers of creating credit in aid of a reduction of prices. You can pay for an article from two sources; the common method of doing it, of course, is by a subsidy in aid of prices. Now a subsidy in aid of prices, of course, is normally collected through taxation, but there is not the slightest reason why a subsidy in aid of prices should be collected through taxation; it can be provided by exactly the same methods by which we provide fresh money at the present time.

4395 (Mr. Brand)

Question : In what way do you mean—by bank credit?

Answer : Yes. The basis of and the justification for bank credit is the fact that you immediately improve credit.

4396

Question : How would the credit be repaid?

Answer : The repayment is involved in the price of the goods, and the ratio of the credit which you can supply under those conditions to the price of the goods depends on the real depreciation of the plant and materials in the country as compared with the real appreciation. You have two processes going on in any industrial country at any time; you have a depreciation, which you can call partly consumption, partly wear, partly obsolescence, and things of that sort, and you have an appreciation which is new plant and many things which I need not go into. In my opinion, the true price of any article is the ratio of depreciation to appreciation, and if you accelerate the appreciation you can lower your prices below what is commonly called cost.

4397

Question : Who pays the difference?

Answer : The physical difference is involved in the ratio of consumption to production.

4398

Question : If I am a producer, and I produce something at a certain cost, do you say that I can, and should be able to, sell at below that cost?

Answer : No, I do not say you can, because you are not a creator of financial credit, as a producer, but the community as a whole can afford to have a system in operation by which it can subsidise you out of credit.

4399

Question : The credit would not be given by the bank but by the community?

Answer : All credit is community credit.

4400

Question : Supposing it is given by a bank; I do not see how the bank gets that credit back?

Answer : You mean the method of doing it?

4401

Question : Yes. To whom does it give it, and from whom does it get repayment?

Answer : That is a matter of the mechanism. One form would be, that it could be given by the bank to the manufacturer and received by the bank from the Treasury.

4402 (Mr. Tulloch)

Question : That involves a large creation of credit, does it not, for the benefit of the manufacturer?

Answer : It does not involve any larger creation of credit than at the present time because the result is to lower prices.

4403 (Chairman)

Question : May I put one point to you incidentally? The defective purchasing power is a symptom of the disease?

Answer : Yes.

4404
Question : In short, we have not enough money to buy things we ought to buy?
Answer : Yes.

4405
Question : If you are going to cheapen commodities by a system of subsidy, the subsidy has got to be found somewhere, and you suggest it should be provided by the community; but after all, as I not (sic) the community, am I not going to supply the subsidy to enable myself to buy cheaper?
Answer : No. As a community, at the present time—putting the matter quite dispassionately—you are divorced from your own credit.

4406
Question : What exactly do you mean, apart from metaphor; how am I divorced from my credit?
Answer : Except for the use of the word "divorced" it is a statement of fact and not of metaphor. You have no power of creating financial credit at all as an individual at the present time. You are in possession of so much cash, you have a certain account with the bank, and the dimensions of that account are limited by certain factors which I feel sure it is not necessary to go into. That, of course, is not the case with the banking system. The banking system, with certain reservations, that is to say, the liability to pay cash on demand, which again is governed by its interlocking with the Bank of England, and the Ways and Means Accounts, which make the thing flexible, has a

very nearly undefined limit of expansion, and that is the difference.

4407

Question : I quite understand that one of the chief assets of a bank is its credit ; it can create credit by, so to speak, issuing its own obligations, and in that sense it can create a very large amount of credit, governed only by what is prudent, which an individual cannot. I do not understand yet how your theory of a subsidy is to be worked out in practice, because it seems to me that the subsidy would in the end have to be found by the people who would have to pay the price of the commodity ?

Answer : I realise the difficulty of moving over from an orthodox point of view to my own point of view, which is, perhaps, a little unorthodox. I look at the position in this way. There is nothing definitive at all about the money system. It is—or it should be ; it is not at the present time—simply a ticket system, which is an adjunct to the general business of producing and distributing goods and services. The money system, as a money system, has no virtues whatever, divorced—I must not use that word again—separated, shall I say, from the industrial system. It is a pure form of convenience to be considered possibly in connection with a system of producing and distributing goods and services. Now the thing to keep steadily in mind, as it seems to me, is : what are your abilities to produce and deliver goods and services and at the same time what are your desires in regard to

using those abilities to produce and deliver goods and services. That is the only thing that really matters. If you start with that objective then your business is to modify to any extent which may be necessary your ticket system to enable you to achieve those industrial and social desires.

4408 (Mr. Tulloch)

Question : It follows from what you say, does it not, that the manufacturer is to get his credit free?

Answer : The manufacturer does not, in the very tentative form in which I have put the matter, get the credit really at all ; it is the consumer who gets the credit. The consumer gets the credit in the form of a reduced price.

4409

Question : I understood you to say that credit would be supplied to the manufacturer, and then you said that there would be no inflation on account of fresh bank credit created, because the price would be less. I assumed he must get his credit free, in order to produce at no greater price ; in fact at a less price.

Answer : The credit which he would get would be to make up the difference between what he would normally charge for his article at the present time, and which, by hypothesis, is too high a price for the consumer to pay, and the lower price which he would be able to pay.

4410

Question : I see ; but does he not get it free? If nobody pays for it he must get it free.

Answer : I am not clear as to exactly what the point is. He is really getting his present price, which he arrives at by ordinary cost accounting methods, from two sources instead of one. At the present time he gets the whole of that price from the public—the consumer. The suggestion is that he now gets his price from two sources, one of which is the credit source, and the other is the public—the cash source.

4411 (Mr. Tulloch)

Question : I see ; but I cannot get away from the fact that he must get that credit free, according to your argument. (Mr. Keynes) And he reduces his price correspondingly. (Mr. Tulloch) Yes, he must ; and if he reduces his price correspondingly he must get his credit free.

Answer : The consumer gets the credit free.

4412 (Mr. McKenna)

Question : And does the bank pay for its credit?

Answer : For the employment of its very valuable mechanism in producing it, or for the actual credit?

4413

Question : For the credit. Are you quite familiar with the working of the banking system?

Answer : Well, reasonably, I think.

4414

Question : Reasonably ?
Answer : Yes.

4415

Question : I suppose you appreciate its working. Supposing for a moment that you are a borrower, and I am a banker. If you come and borrow £100,000 from me you take £100,000 from my cash ?
Answer : Not from your cash, do I ?

4416

Question : From my cash absolutely.
Answer : Well it depends on the form in which I take it.

4417

Question : If you borrow £100,000 you take £100,000 from my cash. You draw a cheque and it is presented to me, and I pay that. I pay it out of my cash ?
Answer : You debit my cash with it.

4418

Question : I have got to find the money ?
Answer : You have to find the credit, yes.

4419

Question : In the first instance I have got to find the money ?
Answer : In what form ? What are we talking about ; in the form of money ?

4420

Question : Money, which would be my cash at the Bank of England ?

Answer : Credit, not cash.

4421 (Mr. Lubbock)

Question : Which you would pay to another banker. (Mr. McKenna) Which I would pay to another banker.

Answer : There would be a transfer. I have no objection to the word " cash."

4422

Question : I, the banker, have got to pay for that £100,000 ?

Answer : You have, as a transferrer of credit, certainly.

4423

Question : For the £100,000 that I lend you I have to pay. Possibly you are not familiar with the working of the banking system. Do you appreciate the fact that the deposits of the bank on the debit side of its balance sheet cost it money to acquire ?

Answer : I see we are at cross purposes. It is a question really of what we mean by " money."

4424

Question : We are under a liability to pay for those deposits ?

Answer : Certainly.

4425

Question : We are paying, perhaps, two or three per cent. for them, taking an average?
Answer : Now I think I see. You mean there is the question of the cost of the money.

4426

Question : Surely!
Answer : The interest cost?

4427

Question : Certainly. Your view is that when a bank lends £100,000, that £100,000 comes back to them or another bank; that leaves its cash intact; but when it comes back to them or to another bank the bank has to pay interest on the new deposit created?
Answer : Yes, as a cost for the services.

4428

Question : And interest for using the money?
Answer : Well, I am using "interest" in the sense of being a payment for the service of using the money.

4429

Question : For the use of the service of money?
Answer : Yes; I was looking at the bank making a reasonable charge for the use of its money. It is obvious it has to make a charge for its staff, and so on.

4430

Question : Who is to pay for that if the consumer gets the credit for nothing? Who is to pay the bank for creating the credit?

Answer : That is perfectly easy. I should regard the interest charged on the money, which is your charge for your services, as being one of the costs of production.

4431

Question : Then the consumer would have to pay for the credit which he receives?

Answer : He would, quite obviously, have to pay a charge for the creation of the credit. That would certainly be so. But the credit would not be a repayable credit. He would get the actual credit in the form of a reduction of price ; two or three per cent, or whatever it might be, for the actual mechanism of creating that credit would be a perfectly legitimate charge, but the difference is the difference between the charge for the credit and the credit itself.

4432 (Sir Thomas Allen)

Question : Would it be a charge in perpetuity?

Answer : No, it would be extinguished by the sale of the goods.

4433 (Mr. McKenna)

Question : Even if you put the charge for the bank credit as low as that, only two or three per cent —it might be more—there is no economy?

Answer : I am afraid I have not made my point clear. The banking system proceeds upon the assumption that the industrial system has to follow the financial system—that if a difficulty arises in regard to the financial system, which, let us say, forms a check on the industrial system, the industrial system has to abide by that decision. In other words, the industrial system has to be subservient to the financial system. My primary proposition is, that the financial system has no *locus standi* at all outside the industrial and distributive systems, and that you can make any changes that you like with perfect ease in the financial system so long as those changes serve the necessities of the industrial and social system.

4434

Question : Up to the moment, without going into the question of whether you should have more or less money, may I take it that your view is that as the quantity of production is increased, if there is to be no fall in the price, the quantity of money ought to increase proportionately ?

Answer : That is broadly so.

4435

Question : Need you go any further than that ?

Answer : Oh ! yes, it is necessary to go further.

4436 (Mr. Brand)

Question : I understand from you that if I am a manufacturer and I go to Mr. McKenna and borrow £100,000 I then use that £100,000 to

lower the sale price of my goods by £100,000 below what they have cost me?

Answer: That is the proposition at the moment, yes.

4437

Question: Then how do I repay Mr. McKenna?

Answer: It is a question of mechanism. I have worked out one mechanism for it.

4438 (Mr. McKenna)

Question: I would very much like to know it?

Answer: Of course, I should like to say, before I tell you what you are asking me to tell you, that in putting forward an explanation of this kind it is not put forward as a final scheme; it is simply put forward for the purpose of explaining how the thing can be done. It is quite possible. This is the form in which I gave it before the Canadian House of Commons a few years ago; it is practically the same question. Supposing that you sold a motor-car for £100—we will make it an easy figure, to keep it in mind—the consumer would pay £100 as at the present time and receive an account for it; he would be given a receipt for the £100. He might conceivably turn that receipt into his bank, which would credit his account with, let us say, £25. The bank might collect the whole of those consumers' credits at any suitable period and turn them over to some Government department like the Treasury, which would credit the bank with the amount that it had credited the consumer. That would finish the transaction so far as the

mechanism was concerned, and the result of that would be that you would have credited to the consumer a proportion of the general credit of the country which by hypothesis is his already, but not credited to him. The result of that would be a lowering of the price of the motor-car by 25 per cent, and there would be an increased sale of motor-cars, or, let us say, an increased sale of all goods, because he would have £25 more to spend on other goods.

4439 (Chairman)

Question : I buy a motor-car for £100 ; I pay £100 and get a receipt from the manufacturer of whom I have bought it, which vouches that I have paid him £100. I take it to my banker, do I ?

Answer : Yes.

4440

Question : And on production of that voucher for £100 he says, " I will credit you with £25 ? "

Answer : Yes.

4441

Question : The result is, I have only paid £75 for the car ?

Answer : Yes.

4442

Question : The banker collects the credit—£25 in this particular transaction, but, of course, there will be a great number of them, because every

commodity will be subject to the same kind of, not necessarily discount, but abatement or rebate?

Answer: Yes.

4443

Question: I do not get the £25; it is credited to my account and the banker pays his voucher into the Treasury?

Answer: The consumer has got the £25. That is really the mechanism. What you have got is a motor-car, which by present methods would cost you £100, for £75.

4444

Question: The banker then collects £25 from the Treasury?

Answer: That is right.

4445 (Mr. McKenna)

Question: Where does the Treasury get its credit from?

Answer: The Bank of England at the present time supplies the Treasury on Ways and Means Account with money out of the credit of the country. That is simply the creation of fresh money. That is the case I think.

4446

Question: That is a double debit to the Treasury. Where does the credit to the Treasury come in? It owes one bank £25; what is on the other side? (Mr. Lubbock) A liability which might be translated, I suppose, into currency notes?

Answer: If the bank so desired.

4447 (Mr. Frater Taylor)

Question : It is your subsidy without taxation?

Answer : It is your subsidy without taxation.

4448 (Chairman)

Question : The Treasury, under this happy doctrine, is going to pay 25 per cent of the cost of my car, is it not?

Answer : No, sir ; it is not. I shall have to take you back to the beginning, if you do not mind my labouring the point.

4449

Question : We are most anxious. We know your views have commended themselves in many quarters?

Answer : Thank you ! I must apologise for being elementary.

4450

Question : You cannot be too elementary for me, I assure you.

Answer : The first point from which you have to start is this : you have at the present time an unused capacity for production. You cannot use it because you cannot sell ; that is point one. Point two is that your financial system is nothing but a ticket system ; it is not a matter of any importance whatever by itself ; therefore, if it is necessary to make adjustments in your financial system then those adjustments can and should be made. Now

your difficulty at the present time is the difficulty that your purchasing power in relation to your prices is insufficient, so clearly you have to lower your prices, or increase your purchasing power; to increase your money you really have to increase your purchasing power. The difficulty in discussing this subject is to keep very clearly in mind the difference between purchasing power and money. If you merely add to the amount of money you will probably not increase your purchasing power, because your prices will automatically rise. In order to avoid that difficulty one method by which it can be done is to lower your prices by means of a subsidy which does not come from purchasing power, which does not come from the public, which is already deficient in money, as compared with the collective prices.

4451

Question: It is just as that point that I think the difficulties begin to emerge. Up to that point I think we might more or less agree with your statement; when you come to the question of remedy it is perfectly true we could produce more if we could sell more, we could sell more if we had more purchasing power, but the trouble is, if you create more purchasing power, and increase the volume of money, then, as you very properly say, the result will be that prices will step up and you will be as you were?

Answer: That is so.

4452

Question : You wish to relate those two things so that you keep prices stable and at the same time increase purchasing power?

Answer : You increase purchasing power if you reduce prices.

4453

Question : Your method is, so to speak, to obviate the rise of price by a counter figure which you call a subsidy?

Answer : I do not call it a subsidy; I use the word "subsidy" for the purpose of making the idea plain.

4454

Question : A rebate, would one call it?

Answer : I should call it a rebate.

4455

Question : It is by means of the institution of a system of rebates; although the price is nominally to rise, it is not really to rise because you are going to have a system of rebates?

Answer : Not nominally to rise. You have two price limits at the present time under the existing state of affairs—probably under any state of affairs in which you use money at all—you have one which is arrived at by the cost accountant, which is simply the addition of all the sums which have been disbursed.

4456

Question : All the factors?

Answer : All the factors. That, I think, is not the price system which in general, for instance, the banker has in mind. He has in mind the relation between the amount of money available and the amount of goods available. In other words, he assumes that the quantity theory of money works throughout the whole of the price range. Well, it does not; it works down to the point where the producer says, "I am getting no money out of this and I will not produce and I will not sell," and no decrease in the amount of money available, no continued deflation, for instance, will seriously lower the price level beyond that point, because everybody goes out of business. Now in regard to what I was saying previously, the price arrived at by cost accounting actually varies as between factories; one factory, perhaps, is more efficient, or is better placed, or has an advantage of one sort or another; the consequence is that if you attack this problem by the crude method of saying, "We will fix prices; the price of a pair of boots shall be 20*s.* 0*d.*," you immediately get into the difficulty that you force the less capable and less fortunately situated producer of boots out of business, because he cannot produce at that price. You want his boots; you do not want to force him out of business; you want the fellow who produces at the lowest price to get the first orders, but when he has come to the limit of his production at that price you want the production at the other price; so instead of having a fixed

price you want to have a lower price level, leaving individual prices still open to competition. Now you can lower the price level by the application to the price level of a creation of credit. You can, quite obviously, physically do it ; there is nothing to prevent your doing it ; your objective is to get rid of goods. The whole of the objective in mind is to produce ; and distribute whether it be by the ticket system, the accounting system, the money system, whatever you like to call it ; your sole objective is to get rid of the goods and to keep the production system going. You can do it ; it is only a question of some form of doing it, and all the mechanism exists in embryo form at the present time.

4457 (Mr. Brand)

Question : Supposing I were a steel producer, and had a factory which was only producing to the extent of 50 per cent, and I could not find buyers, and supposing you were Dictator, what would you do to help me ?

Answer : I should not do anything to help you individually. I should make such arrangements that the price level of steel would be such that you could either sell in this country, or be in a very strong position to compete abroad.

4458

Question : You mean you would enable me to make a profit somehow, although I had to sell my product at much less than it cost me ?

Answer : Yes.

4459 (Mr. Frater Taylor)

Question : You would give a bounty, would you ?

Answer : Yes ; but you must dissociate the bounty from a subsidy. It is not raised by taxation. The method of raising money by taxation is just a pure mechanism, like any other form of mechanism, and you are not obliged to use that mechanism, but the thing that does limit you is how much steel you can turn out in a day ; that is the real physical limit.

4460 (Mr. Brand)

Question : You are not limited at all by the need for the Treasury to advance thousands or millions ?

Answer : Not a bit.

4461 (Professor Gregory)

Question : May I go back to the motor-car ? You say if the motor-car costs me £100 I will get a chit, which I deposit with Mr. McKenna's bank, and he finally deposits it with the Treasury, and by a series of book-keeping entries 25 per cent of additional purchasing power is created ?

Answer : That is one form of mechanism.

4462

Question : That is one form of mechanism, but I do not want to pay too much attention to the consumer's side—what is the position of the manufacturer ? Are you assuming that the car costs the manufacturer £100, or that it costs the manufacturer more than £100 ? Is the actual cost price to the manufacturer what you pay for it ?

Answer : Do you mean, is he making a profit ?

4463

Question : No, I am asking is he covering his cost if he sells at £100?

Answer : Oh! yes.

4464

Question : You are assuming that he is carrying on his business on a perfectly definite commercial basis?

Answer : Absolutely. He is selling in competition with other people who may sell at £99.

4465

Question : Your £25 does not really go to that motor-car manufacturer at all?

Answer : No.

4466

Question : It is added to the general borrowing or purchasing power of the community. Well, I do not see, in those circumstances, how you can prevent prices from rising?

Answer : I cannot see, as a matter of fact, how it can possibly cause prices to rise, again as a matter of mechanism, by this process. Supposing they do rise, your subsidy becomes inoperative.

4467

Question : Let us suppose in a given period of time, one month, the total turnover of consumable goods in this country is £1,000,000,000, and let us take your figure of 25 per cent.; that means that at

the beginning of next month there would be £1,250,000,000 of purchasing power available. I am only using your own figure of 25 per cent.

Answer : No, that is not quite true. I should not regard it, incidentally, as very important if it were true.

4468

Question : Let us clear up that point first?

Answer : The result of your having done this is greatly to increase the total amount of sales in the country. Now, the whole of the price which is collected from the public becomes an item for cancellation, just as it does at the present time.

4469

Question : How do you get it back? You get it from the consumer, you pay it into the bank, who pay it into the Treasury, who get additional credit from some source, but you never do get that back?

Answer : I will pursue this subject as far as you like, but I am frankly much more interested in making you see that the thing is perfectly possible. If you would really like me to get out a considered report as to the mechanism by which it can be done I shall be delighted to do it, my services are entirely at the disposal of the Committee, but the point that I want to hammer home is that it is inconceivable that you cannot get a mechanism which will enable you to equate purchasing power to the capacity to deliver.

4470 (Mr. Keynes)

Question : Is it not probable that those of us who are criticising are not inclined to accept the inherent difficulty which you develop in paragraph 16 of your Memorandum. You divide payments there into A and B payments ?

Answer : Yes.

4471

Question : The cost of production to the manufacturer is A plus B. Of that A goes to the public and is spent by them on manufactured goods, but B goes elsewhere ?

Answer : Yes.

4472

Question : Where else does it go ?

Answer : I felt sure that this would arise, because it generally does arise. May I put it this way ? The wording of this statement is very careful. I always make the wording very careful. I say " Since A will not purchase A plus B, a proportion of the product at least equivalent to B must be distributed by a form of purchasing power which is not comprised in the description grouped under A." I have not said it must be paid.

4473

Question : I did not want to go on as far as that. Just previous to that you see " Group B," which includes raw material. I assume you mean imported raw material ; is that right ?

Answer : " Group B. All payments made to other

organisations (raw materials, bank charges, and other external costs)." Yes; simply what we should call in a company, bills payable at the end of the month.

4474

Question: If they are paid through another business then that business will pay the amount as part of its cost of production to individuals? Is that it?

Answer: Yes, I quite understand the difficulty. The real weight to be attached to this undoubted statement of fact—as it stands it is simply a statement of obvious fact—is whether the transfers from one firm to another are financed by either trade credit or from the firm's own credit, let us say its working capital, or by a bank's credit. The exact weight which that has in the whole of the statement depends to a very large extent on that. If the B payments are really financed from working capital then that working capital must, I think, inevitably have been obtained by the process of investment which is criticised under (b) in the same précis. That is to say, the whole of the savings which have formed the working capital of that concern must previously have appeared in the cost of production.

4475

Question: That would be true, but I thought the emphasis here was on the phrase "other organisations," and what you are saying has no bearing on that.

Answer: I am sorry! I missed that.

4476

Question : I thought the force of the argument here was that it was a payment made by this manufacturing firm to other organisations ?

Answer : Yes.

4477

Question : Its working capital is required to meet its expenditure under Group A during the period of production just as much (as) under Group B, so what you are saying now does not seem to me to distinguish between Group A and Group B ?

Answer : Yes, it does, because in Group A you are paying out to the consumer ; all the payments under Group B are purchasing power, which, if it was obtained by re-investment, was originally in the hands of the public and never gets back into the hands of the public at all.

4478

Question : Other organisations which were receiving money under Group B are getting back that amount from this first one ?

Answer : Yes, that is the case ; but there is a large amount of purchasing power which is permanently retained purely in the productive system, and never gets out into the consumers' system.

4479

Question : If all firms were united in a single firm would your difficulties be overcome ?

Answer : That is the obvious remedy for the financial difficulty but not necessarily the right remedy.

Even from the purely financial standpoint it is a little difficult to say ; you understand a time lag comes in.

4480

Question : You think it would vanish ?
Answer : No, I do not think it would completely vanish.

4481

Question : Why not ?
Answer : Because there would be a considerable amount of money being paid out in wages for delayed production, and your hypothesis assumes that the distributed costs of a given week are the total prices of the goods for sale in the same week.

4482

Question : It would be diminished ?
Answer : It probably would be diminished I think, yes.

4483

Question : In so far as the fact that you have a differentiation in industry means that some people have to have bank accounts which they pay to others, it means you have to create a certain amount of credit, and really it acts as a revolving fund ?
Answer : Yes.

4484

Question : If a revolving fund has been established, why do you have to add to it ?

Answer : If the revolving fund is as large as the total amount of money required to finance the whole of all business from the time the first process takes place to the time the article goes out to the consumer, it is possible—I should not be inclined to admit it off hand—that the question might disappear ; but that is certainly nothing like the actual case.

4485

Question : If you once raise the volume of credit to whatever level may be required by your profit in relation to the volume of production you have only to go on increasing it in proportion as production increases ?

Answer : No ; there are all sorts of questions that would still arise. The question of turnover, depreciation, and the fact that the purchasing power of credit, or whatever you like to call it, which has been transformed into price values of fixed assets in the industrial system would in existing circumstances have to enter into the cost of the goods—and cost items of that type would always raise the price of the articles above the amount of purchasing power.

4486

Question : And if in the interval you had to have new machines to replace old ones you would have to have individuals to produce them. How does that differ from any other form of consumption ?

Answer : Because you are not starting from zero. You are starting from a world as it is.

4487

Question : How does that bear on the matter?

Answer : It bears on the matter that you have a tremendous amount of real capital which at the present time is creating prices and which has not contributed anything like that amount of purchasing power.

4488

Question : Do you mean that the receipts of capital are greater than the amount it pays out in dividends?

Answer : Yes; that is an obvious statement of fact; the accounts of any company will show that.

4489 (Professor Gregory)

Question : What happens to the difference?

Answer : It is represented by the fixed assets in the company which it cannot distribute in the form of money.

4490

Question : It does not distribute it to its shareholders, but if a company earns £100,000 in one year and puts £50,000 towards increasing its plant does not that £50,000 flow out in additional wage payments?

Answer : No, that does not happen at all. What really happens is, that during a given year's working it is necessary to create a number of things like tools, or jigs, or something of that sort, which must be charged in the cost of the product to the consumer. The same result is obtained if profits are invested in new tools.

4491

Question : That is perfectly true. What I am asking you is this : when a motor-car company makes new patterns, and so on, it has to pay its workmen for them just as much as for other things ; consequently it does flow back to the consumer ?

Answer : No, it does not flow back if it is charged to its fixed capital. A company at the end of the year shows a profit of, say, £10,000. We all know perfectly well that probably £8,000 of that is in fixed assets. It distributes of that product £2,000 in the form of dividends ; it is quite obviously only distributing £2,000 out of £10,000 which appeared in prices.

4492

Question : What happens to the £8,000 which it does not distribute ?

Answer : That is in the form of fixed assets, which it is incapable of distributing except by getting a creation of credit to distribute them.

4493

Question : It does not want to distribute these things. What you want, to get the equilibrium between the income of the company in the first instance and its outpayments, is that it should pay somebody for making those fixed assets, and if it pays somebody for making those fixed assets it is in effect returning to the stream what it has taken out ?

Answer : I think I can prove the fallacy of what you are saying, if you imagine that it did distribute

the whole of that £10,000 in a year. By your argument, if it did distribute that £10,000, it would be distributing £10,000 more than it had made.

4494

Question : It has made £10,000 profit?

Answer : Of course it has made £10,000 assets. This is jumping from the money to the goods all the time : it has made certain prices, things to which you attach prices and which are valued in its assets at let us say £8,000. But the money portion of those assets does not amount to £10,000, and it has already recovered the cost of them from the consumer. It is exactly the same thing as going to a man who has had 30,000 acres of land left him by will and saying "That is £1 an acre ; now you have got to pay £10,000 in death duties." The man has not got £30,000. He has got 30,000 acres of land which has a price of £1 an acre. He has not got £30,000.

4495

Question : Nobody ever said that he had?

Answer : He is in exactly the same position as the works which show a possible profit.

4496 (Chairman)

Question : I quite follow that, but after all, the manufacturer is himself a consumer of tools ; he has spent £8,000 in replacing his worn-out tools by new machines, and in doing that he has given employment to people and has paid £8,000 to another manufacturer. He is a member of the

consuming public. The particular commodity he wants is tools. When I buy a box of tools I am a consumer?

Answer: Yes, I quite realise the difficulty; I felt this would arise.

4497

Question: I am sure you are prepared for it?

Answer: Would you bear with me if I read an article which I wrote, which I think will probably be more lucid?

4498

Question: If it is not too long?

Answer: It is not long. It is the shortest form in which this statement can be put, I think. Suppose first that I have £1,000, and I pay that £1,000 away for the purpose of having a house built. We will imagine that the whole of the £1,000 goes in nothing but wages, which does not in any way affect the argument, and we will also suppose that by doing work on something else the workmen could live and save all that they earned by house-building. Suppose now that the workmen who built the house, who collectively would have my £1,000, decided to buy the house, and I agree to sell to them for £1,000. Notice that no question of profit arises. The workmen now have the house, and I have my £1,000 back again. In other words, the workmen have got the house merely by working for it. But these workmen would express it by saying they had paid £1,000 for the house. I am now out of the transaction altogether, and we will

suppose I and my money removed to another planet, or we can suppose that I tore up the money when it was returned to me (which is the equivalent of the repayment of a bank loan). Suppose now that the workmen decide to use the house to make and sell shoes. If they carry on the business on orthodox business lines the cost of the shoes will consist of at least three items: (i) wages, (ii) raw materials, (iii) rent of factory, i.e., house. We will suppose for the moment that they get their raw materials for nothing, and that the "rent" of the house is nothing but an appropriation of money of such amount that when the house eventually falls down they will have got back their £1,000. It is technically called "depreciation." Since the public get the shoes, clearly they ought to pay "depreciation." Notice, therefore, that neither interest—i.e., "usury"—nor dividends, nor land monopoly are imported into the question. But the simple and vital fact remains that the wages paid during the production of the shoes are less than the price of the shoes by an amount, large or small, which is added to the cost of the shoes before the shoes are sold, representing, at least, "depreciation." This amount which is added to the cost of the shoes represents overhead charges in their simplest form, and in many modern productions overhead charges are between 200 and 300 per cent of the direct cost of the product. It is *not* profit.

4499 (Mr. Keynes)

Question : By whom are the overhead charges paid?

Answer : They are put into the cost of the product. They are not paid to anybody. They have in previous cycles of production appeared in the cost of the factory.

4500 (Mr. Tulloch)

Question : Part of them represent the depreciation of the house, which I understood you to say would fall down in a certain period?

Answer : That is the case.

4501

Question : They have not been paid in that case?

Answer : The whole cost of the house was previously paid, in the example, £1,000. Might I just finish and then we will go into it? Suppose in the instance given above that having sold my house to the workmen I had used the £1,000 to build another house, with which I had repeated the identical process. Once again I should have got the same £1,000 back again; once again the workmen would have got into possession of the house, merely by working for it; once again they would have created an overhead charge on anything they manufactured in the house of £1,000; and although there would only be £1,000 of money in existence in respect of the production of the houses there would be £2,000 of prices created in respect of the two houses which would have to be recovered in the price of something sold to the public, and the amount of money and purchasing power would be exactly what it was before the houses were built.

4502 (Professor Gregory)

Question : I do not quite see what you want to prove by this illustration. Is it that there always is a tendency for the quantity of purchasing power to lag behind the volume of output ?

Answer : That is what I am trying to prove.

4503

Question : Supposing one adopted your scheme, how do you think it is consistent with the retention of the gold standard ?

Answer : Well, I am afraid I should be sorry to express my opinion of the gold standard. I think it is archaic. I do not think there is any relation between the gold standard and the necessities of the modern world.

4504

Question : Then practically your scheme boils down to this : in the first instance one would have to abandon the gold standard ?

Answer : I have not considered it from that point of view.

4505

Question : Obviously, if you think the gold standard is archaic, and that the important thing is a continuous system of purchasing-power creation——?

Answer : In the first place I would not agree that you have the gold standard at the present time, in any understandable sense. You have what you call " the gold exchange standard," but it is at

least as flexible, though not so desirably flexible as my scheme.

4506

Question : Certainly it is not as flexible as your scheme. Supposing this were the only country in the world to adopt your scheme, obviously it would be inconsistent with the gold standard ?

Answer : Well, I do not see anything that follows from that. Let me admit it for the sake of allowing you to go on.

4507

Question : You do not think that that might have undesirable repercussions on our position as an international financial centre ?

Answer : I feel perfectly certain for my own part that if we regard our position solely from a financial point of view and do not regard it from a realistic point of view we shall shortly be in a position in which anybody will be able to do anything with our financial position that they like. I do not pretend to be an historian, but it is, I think, common knowledge that you cannot possibly have a solely financial position in the world. It has been tried several times by Venice and other places, with results that are very well known.

4508

Question : Let us admit for the sake of argument that the advantages of your scheme are so great that one ought to sacrifice such benefits as the gold standard brings one. Supposing under your

scheme you could not in fact restrain the price level from rising, what do you think would happen then?

Answer : I should not be prepared to admit that there could be any serious difficulty in making any relation between purchasing power and prices that you wish ; the thing is simply a question of manipulation of figures.

4509 (Mr. Brand)

Question : You mean you can at the same time increase purchasing power and lower prices?

Answer : Undoubtedly ; without the slightest doubt.

4510

Question : To any extent?

Answer : Yes, except that you would eventually arrive at a state of affairs in which you would get a priority problem if your productive system was not sufficiently capacious to meet your psychological demand.

4511 (Professor Gregory)

Question : But I thought you had admitted—in fact, you yourself stated at the beginning of your evidence—that the defect of ordinary inflation sometimes lay in the fact that as you increase the volume of purchasing-power you raise prices. The whole of the validity of your argument turns on the effectiveness of your method or methods of subvention, or subsidy, or whatever you care to call it? Is not that so?

Answer : No, I do not agree at all. My primary object in coming here is not to put forward any

specific scheme. It is to make the point, which I think is obvious, that the real difficulty is the lack of purchasing power ; that the trouble is not in the administrative system, and therefore no gerrymandering of the administrative system, like nationalisation or rationalisation, is going to affect it radically ; it is simply lack of effective demand. I am perfectly certain that the combined abilities of this country can get out a scheme which will increase the effective demand to any amount required if it is once thoroughly grasped. The difficulty is lack of effective demand.

4512 (Mr. Brand)

Question : If I am an individual not wanting to do any work, not producing anything, the remedy is to give me some money, in order that I may have effective purchasing power ?

Answer : I should not deny that. There is no moral question in it at all.

4513

Question : No, no ! We are not importing any moral question into it at all. The remedy would be to give all the population plenty of money ?

Answer : I should not be inclined to deny that.

4514 (Professor Gregory)

Question : Up to what limit ?

Answer : Up to the combined limit imposed by the capacity of the industrial system to deliver goods and services, conditioned by the willingness of the people to work for the time required.

4515 (Chairman)

Question : Would not the industrial system soon cease to operate?

Answer : I do not think so. As far as my knowledge of the industrial system goes, a very large proportion of the people who are employed in the industrial system would be very much better out of it. It is not operating very well just now.

4516

Question : So all the consumers are to be supplied with increased purchasing power. But the consumers are also producers ; they produce in order to obtain purchasing power ; but they are going to get purchasing power from some other quarter, so they will not produce any more, will they?

Answer : The object of having any money system at all interlocked with your wage and salary system is to provide an inducement to produce, undoubtedly, and the problem that you have to meet is that you do not want, as a matter of physical fact, to provide an inducement to produce to the whole of the population at the present time.

4517

Question : Overproduction would be the result?

Answer : Overproduction would be the result. Further than that, the forcing into the productive system of large quantities of unnecessary people really slows up the transformation of the manual productive system into a machine productive system. As far as I can see, there is nothing whatever to be urged against a machine productive

system ; that is the march of events, and it really is a question of use of power.

4518 (Professor Gregory)

Question : Let us put it practically. We get off the gold standard, and you start your scheme by arrangement with the Bank of England ?

Answer : I have not put forward a scheme.

4519

Question : Well, your suggestion. We start by making an arrangement with the Bank of England that any of us who buys anything shall get a bonus of 25 per cent in the shape of bank credit. When would you stop issuing the tokens ?

Answer : I have already elaborated the basis.

4520

Question : I want to know how long this is to go on ?

Answer : The proper price of production which will equate consumption is perfectly easily obtained by the figures of consumption and production.

4521

Question : That is to say, you would continuously increase these subventions so long as there were people unemployed ?

Answer : I am not interested in the unemployed in the least ; I am merely interested in getting rid of the product of the manufacturers.

4522

Question : So long as there was any unused capacity ?

Answer : So long as there was any unused capacity, yes ; which involves the fact that so long as there was any unused productive capacity you could not have " unemployment," until no one wanted further goods.

4523

Question : Supposing you could only get a continuous utilisation of full productive capacity at the expense of rising prices ; which would you choose ?

Answer : That is an important question. Would you mind repeating it ?

4524

Question : Supposing you could only get a continuous utilisation, 100 per cent utilisation, of productive capacity at the expense of rising prices, which would you choose in fact ?

Answer : Well, I should not admit that that was the dilemma.

4525

Question : But it may be. From your point of view you argue that it is not. It is possible to hold the view that it is desirable to increase the volume of purchasing power even though it involves raising prices. I ask you, supposing your own principles are wrong, but that there is something in the idea of expansion of purchasing power, which would you choose ?

Answer : Well, that seems to me to be a very abstract question, because it involves a lot of factors that are not stated. There may be conditions, such as the condition of a country at war, in which production at any cost, raising prices or otherwise, might be—

4526

Question : Normally. You do not want to answer?
Answer : I do not want to answer. I do not think it is a necessary state of affairs, frankly.

4527 (Mr. Tulloch)

Question : In paragraph 14 of your statement in order "to indicate the divergence between the policy which has been pursued in this country and the United States since 1920," you refer to the tremendous increase in the deposits of the American banks and the very small increase in the deposits of the banks in this country. I should like to hear from you what is the divergence between the two policies which has produced these tremendous deposits in the United States and the paucity of deposits in this country?
Answer : Broadly speaking, I should say the result was due to the fact that there is far less insistence on collateral security in American banking than there is in British banking.

4528

Question : And that, you think, would produce the larger deposits?
Answer : Undoubtedly.

4529 (Professor Gregory)

Question : Banks must have some assets, even in America ?

Answer : Yes ; they have the assets of the real credit of the community, which in their case is based on knowledge of character and other capacities of the people with whom they are dealing.

4530 (Mr. Brand)

Question : I suppose the German banks have that ?
Answer : Yes, undoubtedly.

4531 (Sir Thomas Allen)

Question : You advocate the creation of communal credit against bank credit ?
Answer : Yes.

4532 (Mr. Lubbock)

Question : I would like to be quite clear about the £100 motor-car ; the concrete instance. As I understood it, at the end I, the purchaser of the motor-car, had a credit in my bank for £25, and my bank had a credit in the Treasury books for £25 ?
Answer : Yes.

4533

Question : Can the bank draw that from the Treasury if it wishes to do so ? Would you allow the Treasury to print notes and issue them to the bank, and the person with the credit to get them from the bank ?

Answer : If it were required. Of course, the number of notes required would depend upon the volume of business which was conducted.

4534

Question : I, having that credit in the bank, might wish to withdraw notes from the bank to make a purchase ?

Answer : If you wanted, you could have the notes.

4535

Question : So really, in effect, I should have bought the motor-car for £75 of my own money and £25 supplied by the Treasury viâ my bank ?

Answer : Yes, and that £25 is the general credit of the country.

4536

Question : Would that system apply to other purchases ? If I go to my baker and buy bread it would hardly operate then, would it ?

Answer : I do not wish to place too much insistence on this particular form of mechanism which we are discussing ; it is only an exhibit.

4537

Question : One desires to bring the matter down to concrete fact ?

Answer : Yes. I think the result would be that if you applied that sort of thing to a particular industry or a particular commodity you would free a considerable amount of purchasing power which would be applied to the purchase of other

commodities. The result would be that in the first place the unrestricted tendency would be for the prices of those commodities to rise, and you would then have to apply the same thing to the other commodities.

4538

Question : So there would be a rise in price?
Answer : There would be a rise in price in the ones to which the scheme did not apply.

4539

Question : You would gradually extend it?
Answer : Yes. The ultimate general result would be that you would be applying a certain proportion of credit—and by hypothesis increasing the credit of the country—to a reduction of the price level.

4540

Question : You have just stated that people in industries where the rebate did not apply would find that their prices were rising?
Answer : To begin with, if you started by applying it to one instance.

4541

Question : Would they come down again?
Answer : No; you would apply the question of reducing prices to them.

4542

Question : But you could not reduce prices; you could give a rebate to make it easy for a

purchaser to buy, but *ex hypothesi* the price has already been raised?

Answer: No: the price has been raised according to the second canon of the price system, which is, that the price of an article is what it will fetch; that is why the prices have risen; but the first canon is the one to which the subsidy is applied, that is to say, the cost of production, and the cost of production of those articles would not necessarily have risen.

4543

Question: You would have at the outset to select certain industries to which the subsidy should apply?

Answer: No, not necessarily. One method by which it could be done would be to publish a certain definite discount rate which would apply to all commodities right away, and you could apply the credit appropriation to the selling of those commodities at that percentage of the cost of production.

4544

Question: That would not apply to my loaf of bread?

Answer: Yes, it would.

4545 (Chairman)

We are much obliged to you, Major Douglas, for coming this afternoon.

Answer: I am very glad, Sir.

CHAPTER IV

THE EVIDENCE EXAMINED

IN HIS REPLY to question 4379, Major Douglas refers to paragraph 6 of the written evidence supplied by him. That paragraph is printed in the official minutes of evidence as follows:

> "It will probably be admitted that the power and will to produce are sufficiently demonstrated in the foregoing considerations. It would not be seriously contested that the psychological will to buy does not exist, and it seems beyond dispute therefore, that the reason that buying up the power of the ability of the industrial system to produce does not take place, is because there is a lack of money required to pay the prices demanded. In a subsequent section it is proposed to prove that under the existing financial system the general public can at no time acquire by purchase the whole of production, but while this is so, and the *proportion of a given volume* of production which the public *can* buy is probably fixed by the system, *the total volume of production* is almost certainly governed by financial policy."

Whether or no the reader appreciates the "slightly subtle distinction" he will probably feel

that he has done well if he can extract from the paragraph a general idea of what Major Douglas is driving at. Apparently the writer of the words, "It would not be seriously contested that the psychological will to buy does not exist," has confused himself by a double negative, and really intended to say, "It would not be seriously contested that the psychological will to buy exists." With this correction, and by the insertion in the second sentence, between "buying up" and "the power," of the word "to," the paragraph becomes intelligible. One would not wish to appear hypercritical, yet there is a value in precise language of which Major Douglas, as a practical engineer, must be very well aware.

The main contention in his answer to question 4379 is, presumably, that while the total volume of production may vary at different periods, and the actual producers may benefit to some extent from increased production by being able to consume more, they must always produce more than they consume, and the difference is the unsold surplus. In so far as the surplus represents investment abroad, this may be true, but it is not the surplus that Major Douglas has in mind, and in any case the matter is quite beside the point which the questioner was making.

In number 4380 the witness is brought back to the point, and he agrees that it follows from his postulate of an inherent defect, that such defect has existed for one hundred years. Again one is surprised at the

lack of precision in his answer, however, for "In an *accelerating* form," would more correctly describe his meaning.

In replying to question 4384 Major Douglas again refers to the "unsaleable surplus," and in so far as the reference might be taken as applying to the balance of exports which is the physical representative of foreign investment, one might be disposed to agree, although this would not help him in his major premises.

. . . .

Question 4386 presented some difficulty, but although the witness did not provide an answer, he was satisfied that upon investigation a perfectly satisfactory answer could be found.

. . . .

Question 4389 was an invitation to Major Douglas to state the definite proposals associated with his name, and which, it might be assumed, he had come prepared to expound. His approach, however, was, to say the least, a trifle diffident.

. . . .

When, in response to question 4391, he states his "clear idea of what should be done," he does so in a proposition which does not necessarily involve his particular credit theory, and which any advocate of some form of Managed Currency would have little difficulty in endorsing.

In replying to question 4393 Major Douglas insists that merely to increase the amount of money at the disposal of purchasers would cause a general rise in price which would defeat the end in view. It is worth while keeping this admission in mind, because of its bearing on the subsequent argument. He goes on to claim, however, that it is possible to increase purchasing-power by a method that will avoid both the Charybdis of inflation, and the Scylla of a falling price level.

Yet when, in question 4394, he is again invited to explain the process, his coyness reappears, and, a little reluctantly it would seem, he discloses that the method is to use the powers of credit creation to give a subsidy in aid of prices. The proposal here is quite easily understandable. It is, of course, that the cost of goods, to the consumer, should be lowered, and the producer still be allowed to receive his full price, by means of an issue of new money to be applied as a subsidy to the consumer.

Now leaving on one side for the moment the question whether inflation is or is not advisable, the important point is that this proposal is quite definitely inflationary. There is no essential difference between the creation of new credit by the Government in the manner suggested, and an avowed policy of inflation designed to meet expenditure on, say, unemployment relief. Of course Major Douglas could, if he chose, defend a policy of limited inflation, but that is not his object, and in his reply to the preceding question he expressly repudiates the

method of inflation. What was vital to his case was that he should demonstrate to the members of the Committee how it was possible, by his method, to give the producer his full price, and at the same time lower prices to the consumer, without resorting to inflation. This he failed to do.

Question 4396 raises the issue of the repayment of such credits, and of course this point arises from the denial that the method in question would result in inflation. If the credits are not to remain permanently in the money stream, they must be repaid, and the question arises, how and by whom? Major Douglas' reply that the repayment is involved in the price of the goods, is truly amazing.

The reader will at first be inclined to think it can have no meaning, until he discovers, as the interrogation proceeds, that the witness has really persuaded himself, by some strange reasoning, that credits brought into existence in the manner indicated, would be extinguished without loss to the persons concerned, immediately on the completion of the sale to which the credit had been applied.

Yet, surely, the plain inescapable fact is, that if the producer receives his full payment, and the consumer gets his relief, that position can only be maintained so long as the credit remains in existence. The producer desires to pass on the whole of the price he has received, and it remains, throughout every change, in the pocket or the bank balance of some individual. The subsidy which the consumer has received is only of value to him if he can spend it,

and it must continue, as purchasing-power, in the possession of some member of the community.

There can be nothing more certain than that credit so created must remain in the money stream, unless and until it is taken out by imposing an equivalent loss on some individual or individuals. Yet one is forced to assume that Major Douglas has arrived at the conclusion that these credits would be self liquidating, as a deduction from the fact that ordinary bank loans are said to create deposits, and their repayment to cancel them.

From a purely book-keeping point of view this, of course, is true, but the essential fact to remember is that, by adhering to a certain ratio between cash and deposits, the bank allows the volume of its deposits to be determined by the amount of its cash. It has, therefore, at any particular period, a certain ascertainable sum available for lending, and it aims at employing no less and no more than this sum. As loans are repaid, therefore, they are immediately re-lent, except in so far as a reduction in its cash may compel it to lessen the volume of its deposits.

Mr. Brand's question, " How would the credit be repaid ? " touches the root of the matter, because if the new money remains in use, as it must until it is repaid, the result will be inflation. Whether that inflation merely equates a prior increase in production, or whether it goes beyond and produces the harmful effects usually associated with inflation, is a question which resolves itself as the interrogation proceeds.

But in this same reply Major Douglas goes on to define the limits of the credit creation which he is

advocating. Its volume is to be determined by the ratio between appreciation and depreciation, and he finally argues that the true price of any article is this ratio, and consequently may be below cost.

Now if he were content to claim that any expansion of the machinery of production should be met by a corresponding expansion of purchasing-power, his ratio of appreciation to depreciation might indicate the measure of the expansion of purchasing-power required. It is an entirely logical and reasonable claim, that, rather than allow increased production to lower the price level, and in consequence inflict blow upon blow on industry, it is better to cause purchasing-power to step up in time with production.

Indeed one might go further and agree with Major Douglas that a very great deal of potential expansion is prevented because industry cannot sustain the serious fall in prices which is at present the main avenue through which increased production takes effect. To equate purchasing-power to production is a very practical and desirable object. It is the central motive of every advocate of a Managed Currency, and as a principle it would certainly have received the support of some members of the Macmillan Committee.

But although Major Douglas, when in a difficulty with his proposals, frequently falls back upon the enunciation of this principle, it is abundantly clear that his scheme goes far beyond merely providing the additional spending power required to balance a greater volume of goods for sale. This fact is very clearly illustrated in the concluding sentence of his

reply to question 4396, in which he maintains that it is possible to lower prices below the actual cost, and this claim follows naturally on the contention in his A and B theorem that B costs, representing the greater part of the price of commodities, are not available as purchasing-power.

If it is true that for every pound's worth of goods which the public ought to be able to buy, it is supplied with only about ten shillings with which to make the purchase, then it follows that it ought to be possible to supply the consumer with goods at half their cost price, and still be doing no more than equating purchasing-power to production.

But if we ignore, for the moment, this underlying assumption, and presume that the price reduction will be limited by the expansion of productive *capacity*, it is still the case that Major Douglas is proposing to apply a presumed future saving in the cost of production to the purpose of assisting consumers to buy existing stocks of goods. In other words, he proposes to fictitiously lower present prices to the consumer by making a draft on the future.

By such a method, apart from technical difficulties, the value of appreciation would have been absorbed before the appreciation actually matured, and the cost (to the consumer) of the increased volume of goods, when they came upon the market, could only be prevented from springing back to the original figure by assuming a further expansion and drawing another draft on the future. Major Douglas' proposal (even on the assumption that the process of credit issue would be governed by the expansion of

productive capacity resulting from technological improvement) is rather like eating our cake before we have it, because even if the mechanism which he proposes were possible, his plan would still amount to a continual process of gambling on a future increase of production in order to distribute the value of that increase beforehand.

In question 4397 Mr. Brand was still trying to discover how the gap between cost price, which the producer would receive, and the new price, which the consumer would pay, was to be bridged. The only proposal submitted was that the gap should be filled by an issue of credit, but this only meant that the liability would be placed on the shoulders of the community as a whole, and that they would have to pay it in enhanced prices in the future; or alternatively that some person or persons would repay the credit and so take the liability off the community. Major Douglas had disputed that there would be any communal liability in the form of increased prices, and so the question remained to be answered, "Who pays the difference?"

The witness' reply that "the physical difference is involved in the ratio of consumption to production," is no answer to the question at all; it merely relates one difference to another, and does not explain how the proposed reduction in price is to be met.

In his answer to 4398 Major Douglas again indicates that the source from which he proposes to draw his subsidy is financial credit, and in the questions immediately following, Mr. Brand continues his attempt to discover where the final responsibility would rest.

The reply to 4401 indicates that the credit would be received by the manufacturer, from the Treasury, viâ the bank ; but since the Treasury has no means of recovering it from any source other than the taxpayer, it must be presumed to be a creation of new money ; in other words, inflation.

The answer to Mr. Tulloch's question (4402) is surely a monument of absurdity. To suggest that Major Douglas' plan does not involve any larger issue of credit than at present, is to overlook entirely the fact that he bases his whole case on the need for more purchasing-power, and proposes to make good that deficiency by an issue of credit. If the supply of credit is not increased, and the price which the manufacturer receives is not reduced, how can he claim to be correcting the shortage of purchasing-power which he believes to exist ?

But, perhaps, the most amazing piece of sophistry is the *reason* he advances in support of the contention that no increase in credit creation is involved. The effect of an issue of credit is to *raise* prices, not to lower them, and when Major Douglas says, " It does not involve any larger creation of credit than

at the present time because the result is to lower prices," he is defending an obvious inaccuracy by a contradiction.

The fact is that he does propose a very large issue of additional credit, and the effect of that issue must be to cause a rise in prices which will persist through each successive cycle of production, unless, and until, it is overtaken by a further expansion of production. In proposing to use this credit to lower prices at the consumer's end only, he is not really lowering the price level at all; he is merely proposing to use new money which is going to have the effect of permanently raising future prices, for the purpose of assisting the public to buy certain articles at present on the market.

A parallel might be found in the case of a man who met the difficulty of an insufficient income by borrowing a sum of money at interest and using the principal to supplement his ordinary income. Quite obviously, he would only have escaped from his present difficulties by increasing his future liabilities, and the same policy could only be continued by drawing more and more heavily on the future.

The method Major Douglas proposes is almost precisely similar. When he speaks of creating new credit and using it as a subsidy in aid of prices, he is really proposing to borrow a capital sum from the future, in order to spend it at the moment, and the effect upon future prices may be taken as a rough equivalent of the interest charges in the previous illustration. His reduction in price is no real reduction at all. The original price remains

untouched, in the case of the present purchases, because the producer receives it in full. What really happens is that a subsidy is given to the consumer to enable him to buy a particular article, at the expense of raising all prices to all consumers in the future.

If a claim so extraordinary as that involved in the reply to Mr. Tulloch's question could be supported, why stop at the 25 per cent reduction which Major Douglas suggests at a later stage? If an issue of credit, applied as a subsidy to a particular sale, negatived the credit because it effected a lowering of the cost to the consumer in that instance, why not increase the credit to 100 per cent and present the goods to the consumer free? Such a proposition is, of course, disproved by its own absurdity. Yet if the answer given to Mr. Tulloch's question does not mean that the credit is cancelled because it is used as an aid to prices, it has no other intelligible meaning.

In the replies to questions 4403 and 4404, Major Douglas reaffirms his earlier contention that there is not sufficient purchasing-power in the hands of the public to buy the goods available for sale. This claim is vital to his case, and yet, as will be seen in connection with the reply to a later question, it involves a complete refutation of his credit proposals.

In number 4406, the witness had in mind the fact that the right to create credit is vested, as a

monopoly, in the banking system. When he said, in his answer to the previous question, that the community is at present divorced from its own credit, he was, presumably, expressing the view that the credit, which the banking system is permitted by the State to bring into existence, should be the monetary equivalent of additional wealth which the community has created.

In this sense it is true that the new money, which increased wealth has made necessary, belongs, morally, to the community ; because it is simply the representative of that additional wealth, and the community which has made the real asset, cannot, of itself, proportionately increase the total nominal value attached to all wealth, but must wait on the banking system. Yet when Major Douglas says that, with certain reservations, the banking system has a very nearly undefined limit of expansion, he is putting the claim too high.

In actual practice those limits are fairly well defined. In the case of the Central Bank, which has an effective control over the volume of cash held by the Joint Stock Banks, the limit is set by the necessity to preserve the value of the national currency in the foreign exchange markets. So long as the Central Bank is carrying out its primary function of maintaining a stable currency, it cannot be said to have unlimited powers of credit expansion, because, if it embarked on such expansion, the value of its currency would fall. The Joint Stock Banks, as a matter of prudence, aim at preserving a proportion of cash to deposits of 10 or 11 per cent, and although the relative proportions between advances, discounts,

and investments may vary, deposits as a whole are kept closely to the figure set by this proportion.

In addition the Central Bank watches closely the operations of the Joint Stock Banks, and if they appeared to be overstepping the bounds of prudence, by a too liberal credit policy, it would immediately take steps, by raising the bank rate, or by selling securities in the open market, to either discourage borrowing, or to reduce the amount of cash reserve held by the banks.

The reply to question 4407 is typical of Major Douglas' method whenever he is brought up against a logical difficulty. His opening remarks indicated that he appreciated the force of the objection developed in the question, but instead of making the obvious deduction that the onus of meeting the point rested with him, he preferred to assume that the difficulty was with the questioner, who was finding it hard to emancipate himself from the limitations imposed by his orthodoxy.

The Chairman of the Committee had made a perfectly logical deduction, by which he arrived at the conclusion that the proposed subsidy in aid of prices would have to be paid by the people who were to receive it. Now Major Douglas was stating a case in support of his particular proposals, and the Committee were examining it. If their examination placed him in a dilemma from which he could not escape, he was bound to fail.

It was, therefore, vital to his case that he should find a solution to the problem which the question

posed. That his reply made no serious attempt to do this, even his most ardent adherents cannot reasonably deny.

To say "there is nothing definitive about the money system," or that it should be "merely a ticket system," provides no answer. It may be perfectly true that it is a "pure form of convenience"—an "adjunct to the general business of producing and distributing goods and services"; it may be true that "your business is to modify to any extent which may be necessary your ticket system," but this does not prove that the particular modification which Major Douglas has proposed is either practicable or desirable. It does not commence to show how it is possible to give relief to the consumer, in the form of an issue of credit, without taking it back from him in the form of enhanced prices.

Major Douglas has, apparently, yet to learn that a question is not answered by merely stating an obvious, but entirely irrelevant, fact.

The reply to question 4408 seems to indicate some confusion in the mind of the witness as to the particular procedure he wished to suggest. When replying to question 4398, he was responsible for the proposal that the community should subsidise the *producer* out of credit. Again, in his answer to 4401, he said, "One form would be, that it could be given by the bank to the *manufacturer*," and when Mr. Tulloch, in the question which followed, suggested that this would involve a large creation of credit for the *benefit of the manufacturer*, the witness denied that

it involved a larger creation of credit than at present, but did not object to the suggestion that it was for the *manufacturer's benefit.*

It was, consequently, difficult for the questioner to get a clear impression of the arrangement intended, when Major Douglas informed him that, "The manufacturer does not, in the very tentative form in which I have put the matter, get the credit really at all ; it is the consumer who gets the credit." At a later stage, in the course of his reply to question 4438, the proposal was further modified, and the witness suggested that the credit should be given (through his bank) to the *consumer*, on production of a receipt for goods purchased.

Were it not for the fact that Major Douglas' proposals have been before the public for a number of years, and that during this time he has had many opportunities of discovering the objections and as far as possible remodelling his proposals to meet them, one might be forgiven for concluding that, in his evidence before the Macmillan Committee, he was merely improvising.

In questions 4409, 4410, and 4411, Mr. Tulloch was still trying, unsuccessfully, to ascertain whether an issue of free credit was contemplated ; his difficulty, clearly, being, that unless it was free the consumer could not get his reduction in price, whilst if it was free the result would be inflation. Then, in question 4412, Mr. McKenna took up the examination, and carried the enquiry back to the position of the banker in the transaction.

It is interesting to notice, here, that although the question was, whether the bank *paid* for the credit, Major Douglas replied as though the question had been, "Does the bank charge for its credit?"

Mr. McKenna's view was, presumably, that the witness was at a disadvantage in not being correctly informed as to the mechanism of banking, and his question (4415) was intended to clear up a misapprehension. That the misapprehension existed was made quite clear by the reply which Major Douglas gave.

The point which the questioner was endeavouring to make was that a bank loan is an actual transfer of money, and really depletes the bank's lending capacity by the amount of the loan. This will be seen to be the case when it is considered that the borrower may, if he chooses, withdraw, in cash, the whole of the amount placed to his credit, and deposit it in his own private safe. It is true the banking system presumes that he will not do this, and has acted on this presumption, but the fact remains that the money has technically gone, and only returns as a new deposit, *for the use of which the bank is liable to pay.*

The banker is, in fact, a dealer buying and selling the service of money. In the example taken by Mr. McKenna, he sells the use of £100,000 and when that £100,000 comes back from various sources, he has to buy back the service of it, so that he can sell the service again. Of course this particular £100,000 may be distributed over various bankers,

but their loans will be distributed in the same way, so that Mr. McKenna would, in the long run, get his £100,000 back, yet only by buying back the right to use it.

This is essentially the banker's function, to buy and sell the service of money, and not, as Major Douglas appears to think, to control an inexhaustible supply of credit and charge a price for its use. It is true that in the first instance the banks create the new credit which is brought into existence. If, for example, the Central Bank takes steps which increase the cash reserves of the Joint Stock Banks by £10,000,000, they in turn by extending their loans and investments can allow their deposits to increase by approximately £100,000,000, and the difference of £90,000,000 will be new credit which they have created.

But without the authorisation provided by this increase in their cash reserve, they do not, in actual practice, create new credit, but confine themselves to buying the use of existing money, and lending as much as they can with safety.

In his reply to question 4420, Major Douglas endeavoured to draw a distinction between credit money and cash, but this is really a distinction without a difference. All credit money, as soon as it is created, ranks equal in value to the already existing money, and becomes in fact convertible into cash. The borrower receives, not credit but money, and it is no concern of his, as a borrower, whether the bank lends him existing money or brings new money into existence for the purpose.

Major Douglas appears to recognise this fact in his answer to question 4421, although he seems to hedge again in dealing with 4422.

The next few questions drew from the witness the admission that bank charges, and also interest charges, would have to be met, and in reply to question 4430, asking who is to pay the charges if the consumer gets his credit for nothing, he said, " I should regard the interest charged on the money, which is your charge for your services, as being one of the costs of production."

This reply suggests that the witness was not at all clear as to what was involved, for if the consumer is to pay any interest at all on his credit, he must pay it for ever, or until he repays the credit. Otherwise, for what period would he be required to pay ? Would it be for three months, six months, or twelve months ? On what basis, and by what circumstances, would it be possible to determine how short, or how long, should be the liability of the consumer to pay interest for the credit he receives ?

That the consumer would be incurring a liability to pay interest in perpetuity on his credit, was clearly not what Major Douglas had in mind, and yet there could be no data upon which to determine the extent of the liability except the termination of the credit. Obviously, he was falling into confusion on this point, and should have resisted any suggestion that interest charges could arise on the credits, although he might have admitted a non-recurring bank charge to cover the cost of issue.

The position would then have been that the bank would receive the credit from the Treasury, and pass it on to the consumer, charging his account with the cost of the service. The consumer would draw on the credit to make other purchases, and the money so drawn would return to the bank, or some other bank, but only in the form of a new deposit for which the bank would be liable to pay.

Major Douglas had merely made an unnecessary admission, therefore, in burdening the consumer with an interest liability of indefinable dimensions, and since he could not assume a perpetual liability he was still left with his problem, how to liquidate the credit he had created.

The dilemma resulting from this admission of interest charges, crops up in question 4432. Sir Thomas Allen evidently had in mind the fact that interest must be a recurring charge, and the implication behind his question was, that if it was not a charge in perpetuity, the credit must be repaid. Now this was the same difficulty which Major Douglas had previously failed to overcome. He had brought his credit into being to provide a subsidy for the consumer, but his embarrassment was that he could not send it out of existence again.

The very essence of the matter, from the consumer's point of view, was that he should be able to spend his credit, and once he had spent it the money would have got into the money stream and all Major Douglas' arguments couldn't get it out again without making someone pay. He would not admit

the suggestion contained in Sir Thomas Allen's question, yet he could not explain any process which would dispose of the credit. He contented himself, as before, with merely making an assertion which was incapable of proof.

. . . .

The reply to question 4433 is interesting, as another example of Major Douglas' controversial method. He met the objection by assuming a failure on the part of the objector to grasp his point of view, and then proceeded to give expression to certain more or less platitudinous statements, which did not necessarily involve his particular proposals, and which provided no solution of the problem to which his attention had been directed.

It would be possible to agree that "you can make any changes that you like with perfect ease in the financial system so long as those changes serve the necessities of the industrial and social system," but this presumes that the changes are practicable, and necessary, and does not assist in the slightest to solve the practical difficulties attaching to Major Douglas' specific proposals.

. . . .

Number 4434 restates the general principle upon which Major Douglas appears to fall back each time the questions become searching—the principle that purchasing-power should be related to production—and 4435 suggests the limitation of his proposals to the implementing of that principle.

The witness refused to be so limited, however, and the plain inference was that his concern was

not really with a deficiency of purchasing-power such as the questioner had in mind, but rather with the inherent, and continuous deficiency which his proposals are designed to correct. His credit theory is based upon this postulate of an inherent deficiency of purchasing-power, which, even if corrected by the usual methods, would immediately reappear, because, according to the argument, it is impossible for the present system (unaided by some method such as Major Douglas advocates) to distribute purchasing-power at the same rate that it creates prices.

The case which the witness was trying to make out was that purchasing-power could not possibly be equated to production within the present pricing system, and in order to make out his case he had to prove, first that his postulate of an inherent, as opposed to an accidental, deficiency was correct, and secondly that his method provided the right remedy.

His constant appeal to the general principle that purchasing-power should be equated to production was therefore quite beside the point. It was totally irrelevant to his real claim, because it could be readily assented to by people who disagreed entirely with his whole credit theory. Again and again, in Major Douglas' evidence, one notices a tendency to assume that the statement of a general principle is sufficient justification of a specific proposal ; yet when, as in the present instance, an attempt is made to confine him within the bounds set by this general principle, it becomes clear that he desires to pass those frontiers to particular proposals which the principle cannot be said to authorise.

The desire to equate purchasing-power to production may be the motive for a variety of plans, but each plan must stand on its own logical defence. To state the principle which has given rise to the plan may be interesting as indicating its origin but is quite inadequate as a justification of the method.

In questions 4436 and 4437, Mr. Brand once more took up the enquiry regarding the repayment of credits, and elicited from Major Douglas the reply, "It is a question of mechanism. I have worked out one mechanism for it." Here, at last, we seem to be promised a solution to the problem which has been facing the witness from the commencement.

Number 4438, which followed, was an invitation to explain this mechanism, and again one notices the curiously guarded manner of his approach. Of course, if the Committee had been satisfied on fundamentals—if the general lines of his scheme had been approved—then the working out of the details might be a matter for selection and adjustment. But the proof that Major Douglas' plan was practicable had never been produced, and he was merely begging the question when he insisted that the scheme was "quite possible."

What the Committee desired was proof that it was possible. Major Douglas offered, not proof but assertion, and having built his case upon this insecure foundation, proceeded to explain, not a mechanism which would secure the repayment or

cancellation of the credits, but a method of issuing them which stopped short at the crucial point.

The illustration which he gave brought the real problem no nearer solution. The manufacturer, who had figured a great deal in the earlier discussion, was now left completely out of the matter, and the suggested procedure was that the consumer should receive, through his bank, a credit which was to be provided by the Treasury. And, says Major Douglas, "that would finish the transaction so far as the mechanism was concerned."

Yet the new money which the credit represented would still be in the money stream, and if the matter rested there, the charge of inflation would remain unanswered. Once more the explanation had merely gone round in a circle, and the Committee were back at the question from which they started, "Who is to pay for the credit?"

Any reference to this particular answer would be incomplete if it omitted to notice the claim with which Major Douglas concluded. According to him, the result of the process he had been describing would be that a proportion of the general credit of the country would have been credited to the consumer, and as a result of that, the price of the motor-car would have been lowered by £25.

Now here, undoubtedly, he was indulging in loose thinking. Leaving on one side for the moment the question regarding the final disposal of the credit—whether it was to be repaid, or whether it would remain a general charge on the community—it is clear that, by putting the consumer in funds to the extent of £25, the Treasury would have assisted him

to buy his car. But how can that be said to have lowered the price of the motor-car by £25?

The manufacturer has received the full price, £100, and the consumer has paid £100, and the fact that he recovers £25 from the Treasury has no effect whatever on the price. If my young son has a shilling, and wants to buy a two-shilling knife, and I give him another shilling to enable him to make the purchase, according to Major Douglas' argument I have reduced the price of the knife by 50 per cent.

Let not the reader imagine this is mere hair splitting at Major Douglas' expense. The distinction is important, because he bases certain of his arguments on the claim that his method achieves a lowering of the price level, when in reality it only proposes to provide the consumer with part of the cost, and leaves the price to be determined by circumstances as at present.

The next few questions were occupied by the Chairman in going over the various points of the illustration, and then, in 4445, Mr. McKenna, still curious about the origin and final destination of the credit, enquired, "Where does the Treasury get its credit from?"

Major Douglas' reply appears to suggest that the Bank of England has an unlimited supply of credit, upon which the Treasury may draw without being under any necessity to make repayment. If this was not his belief, there does not appear to be any point in the reply. Such a belief is quite erroneous, however. The Central Bank's powers of creating credit

are strictly limited by the necessity of preserving the value of the national currency at home and in the foreign exchange markets, and a policy of credit expansion of the dimensions necessary to support Major Douglas' proposals would soon have a disastrous effect on the exchanges.

In the second place, Ways and Means advances made by the Bank of England to the Treasury are merely bankers loans, and are repayable by the Treasury as soon as it is in funds.

In the end, in reply to Mr. Lubbock, the witness admits that the Treasury might translate its liability into currency notes. Here, at long last, we have an admission which can mean only one thing, that the process outlined by Major Douglas is indistinguishable from ordinary inflation.

Question 4448, and the reply, are interesting from a psychological point of view, though not very important from the standpoint of the investigation. The Chairman's question, although perhaps a little derisive in its tone, was a perfectly logical deduction from the particulars which the witness had given. His flat denial, therefore, seems to have been prompted more by irritation than by intelligent disagreement, and his recapitulation, in so far as it had any direct bearing on the point at issue, left the question precisely as the Chairman had stated it.

Had any doubt existed upon this point, it would have been completely dissolved at a later stage, when, in reply to Mr. Lubbock's question, number

4535, Major Douglas agreed that the motor-car would have been bought for £75 of the consumer's money and £25 supplied by the Treasury ; which was the exact equivalent of the Chairman's proposition in 4448, with which Major Douglas had tartly disagreed.

In 4450 Major Douglas reiterated the general principles which he had already laid down, and to which, in the main, anyone might readily subscribe. Toward the end of his statement, the following remark occurs : " If you merely add to the amount of money you will probably not increase your purchasing-power because your prices will automatically rise."

Does not this precisely fit the particular proposal which he had been making ? The £25 which the Treasury would credit to the consumer, and which it might issue notes to cover, would unquestionably be new money, and its effect would be to cause prices automatically to rise.

When Major Douglas claims that he has overcome this difficulty because he has lowered prices, he is talking sheer unadulterated nonsense. The price of the motor-car remains at the original figure £100. The consumer has paid £100 for it, but because he had only £75, the Treasury has provided him with the other £25.

Right from the outset the claim is that the consuming public is provided with insufficient purchasing-power, and the purpose in issuing the credit is to make up this deficiency. If we assume,

for the moment, that Major Douglas is right in his first assumption, and if we agree for the sake of the argument that his method will correct the deficiency, we merely arrive at what would have been the position if the deficiency had never existed.

Instead of being provided with only a proportion of the money necessary to buy all the available goods, the consuming public now has the right amount of purchasing-power, because the portion which it should have got, but did not receive, through the ordinary channel has been supplied through another channel. If we grant all Major Douglas' premises then, it follows that he has enabled the consumer to buy at the full price, but he certainly has not succeeded in lowering the price. If, on the other hand, his premises are wrong, he has merely created new demands on goods already fully claimed on the basis of money in circulation, and depreciated the value of all money in consequence.

The same point crops up in his reply to question 4452. Major Douglas really does not seem to have made up his mind whether he is proposing to increase purchasing-power or to reduce prices. He claims the existence of a gap, and he could close this gap either by lowering prices to meet purchasing-power, or by raising purchasing-power to meet prices.

The mechanism which he had been explaining to the Committee would have the effect of building up purchasing-power, yet he persists in believing

that he is approaching the matter from the other direction and scaling down prices.

Although only a minor point, it is perhaps worthy of note that when, in replying to 4453, Major Douglas objects to the term subsidy, he is objecting to a term which he had introduced, and which he had used in reference to his proposals, as late as when replying to question 4450.

In dealing with questions 4455 and 4456, the witness covered a great deal of ground without arriving at any point which materially supported his case. In the first place, he stresses the claim that the "quantity theory" of money does not work downward below the price at which it is profitable for the producer to sell.

It is undoubtedly true that there is a sort of stop figure, below which prices cannot fall without loss or bankruptcy for the producer, and this may quite legitimately be used as an argument against a policy of allowing technological improvement to become effective through a falling price level. It would, however, have been of more material assistance to Major Douglas' case if he could have shown that there was a limit to the upward movement of prices consequent on an increase in the quantity of money.

His next point was that, owing to variations in the cost of production, as between efficient and less

efficient factories, a fixed price, if related to the superior capabilities of the most efficient factories, would drive the less efficient ones out of business. But why not fix the price in relation to the least efficient factory which it is desired to keep in business ?

The difficulty does not seem a very real one, and in any case the argument is directed against a possible alternative, and not toward the support of his own scheme.

Major Douglas then goes on to say, "Now you can lower the price level by the application to the price level of a creation of credit. You can, quite obviously, physically do it; there is nothing to prevent your doing it."

Now it has already been pointed out that you cannot lower the price level by an issue of credit. What you can do is to assist purchasers to buy, at their full price, goods already on the market, but only at the cost of increasing the number of claims on future supplies of goods. Major Douglas is completely wrong in his assertion, therefore, because, quite obviously, it is physically impossible to lower the price level by increasing the volume of purchasing-power.

You may, conceivably, have other influences operating which have the effect of lowering prices, at the same time that you are tending to raise them by increasing purchasing-power ; you may adjust the two sets of operations, so that they equate each other, and prices remain stationary ; but whether you offset it in some way, or whether you allow the effect to disclose itself, the plain fact remains, that

by increasing purchasing-power you are automatically raising prices.

Mr. Brand's question (4457) brought the matter back from the region of generalities to a concrete instance, and Major Douglas' proposal in the case of the steel manufacturer with a 50 per cent output was to subsidise him with credit, so as to enable him to make a profit somehow, although he had to sell at less than cost. To Mr. Brand's question "You are not limited at all by the need for the Treasury to advance thousands or millions?" he replied, "Not a bit."

The series of questions which followed from Professor Gregory led up to number 4466, in which, having elicited the fact that the credit had been added to the purchasing-power of the community, he says, "Well I do not see, in those circumstances, how you can prevent prices from rising."

All the facts support Professor Gregory's conclusion, and the point was vital to Major Douglas' case, yet he refrained from attempting a reasoned reply, and was content to answer with a bare denial.

In 4467, Professor Gregory pressed the matter further, and demonstrated how, in a given period, the amount of available purchasing-power would have been built up to a figure which was 25 per cent

greater than in the previous period. The argument was clear and perfectly logical, and it was certainly important because, if true, it meant that Major Douglas' method, when examined, simply amounted to increasing the quantity of money in people's pockets—a process which he had already claimed would produce inflation.

His answer, that it was not true and, even if it were true, would not be very important, cannot be taken seriously.

The questioner persisted with his point, however, and then we get this reply, "The result of your having done this is greatly to increase the total amount of sales in the country. Now, the whole of the price which is collected from the public becomes an item for cancellation, just as it does at the present time."

The first part of this reply is true in so far as the public, supplied with 25 per cent more money, could purchase 25 per cent more goods, that is, provided we assume that the inflationary effect of the new money would not be immediately felt. The latter part of the reply, however, is a perfect example of Major Douglas' method.

In what way does the whole of the price collected from the public become an item for cancellation, and just how does this happen at the present time?

Ordinary prosaic individuals, not gifted with the special insight of Major Douglas and his supporters, can only see that all the money which the public pays for goods is again disbursed by the shopkeepers, the wholesalers, and the manufacturers, and, in the

process of replacing the goods, tools, plant, machinery, and buildings which are being consumed, comes back once more as purchasing-power.

There is no such thing as an automatic cancellation of purchasing-power after it has served one series of transactions. It continues to circulate in an endless chain, carrying around cycle after cycle of production, and Major Douglas' difficulty is that he cannot discover any form of purchasing-power which will give the consumer a right to more goods now without permanently adding to the money stream and raising prices against him in the future.

And if it be said that the reference is not to money but to the price which is collected from the public, the reply is that you cannot collect an abstraction, and neither can you cancel it. Only in *Alice in Wonderland*, could the grin be separated from the cat. In everyday life only money is collected from the public, and price is no more than an index to the quantity of money so collected against a particular transaction.

Not to be diverted from his point, Professor Gregory returned, in 4469, with the question, " How do you get it back ? "

Major Douglas was in a real difficulty. The logic of the argument was fatal to the claims he had been making. He could find no satisfactory answer, because there was no answer consistent with his theory. Under these circumstances he chose the method of evasion, but evasion so transparent that one can

almost imagine a gasp of astonishment from his audience.

What the Committee desired was, not that he should prolong the discussion indefinitely, but that he should do the very thing that he declared himself anxious to do—demonstrate to them that his plan was possible. Each question put to him was designed to test the truth of his contentions, or to expose what seemed to the questioner a flaw in the argument.

The Committee could only be convinced that his theories were practicable by receiving satisfactory answers to their pertinent questions. The witness repeatedly failed to give such answers, and fell back instead on assertions, irrelevancies, or general statements, and the conclusion seems irresistible that what he really desired was, not so much the opportunity of proving his case, as that the Committee should accept his assurance that his plan was possible.

Finally, in this reply, he had recourse once more to his *pièce de résistance*, with the words, " the point that I want to hammer home is that it is inconceivable that you cannot get a mechanism which will enable you to equate purchasing-power to the capacity to deliver."

Now had this really been Major Douglas' sole or even his main object, he might have gone away quite contented, for probably no member of the Committee would have disputed it with him. Indeed there can hardly be a single intelligent person who would not agree that it is, theoretically, *possible* to equate purchasing-power to the capacity to deliver.

Possibly some might contend that it is actually achieved at present; others might dispute the

necessity or the wisdom of doing it; others, and amongst them some members of the Macmillan Committee, would not only have assented to the proposition, but would also have agreed with Major Douglas that it was desirable it should be put into practice, and yet at the same time would have disagreed entirely with his method of doing it.

This tendency to argue from the general to the particular seems to be a weakness with Major Douglas, for he is constantly assuming that the acceptance of a general principle carries with it approval of whatever form of mechanism he proposes for putting it into effect.

With question 4470, Mr. Keynes endeavoured to locate the fallacy contained in Major Douglas' proposals, in his initial assumption of an inherent deficiency of purchasing-power, and directed attention to that part of the written evidence which reproduced the argument (already discussed in chapter two) commonly known as the A and B theorem.

Then, referring to those payments which are grouped under B, and which Major Douglas contends are not distributed to the public, he asked, in question 4472, " Where else do they go ? "

The question was clear and direct, and the witness was apparently in no uncertainty as to its meaning when he replied, " I felt sure that this would arise, because it generally does arise."

One would naturally assume that a point which

generally arose out of a consideration of these proposals, and which the witness was expecting to arise on this occasion, would be met by an unequivocal reply. What are we to think then, when, in answer to the question "Where else does it go?" Major Douglas replied, "I have not said it must be paid."

The reader will remember that, in question 4471, Mr. Keynes had quoted from the written evidence to the effect that, "The cost of production to the manufacturer is A plus B. Of that A goes to the public and is spent by them on manufactured goods, but B goes elsewhere."

The witness had assented to this, and the question had followed immediately, "Where else does it go?"

It seems almost inconceivable that Major Douglas could have misunderstood the point here, and yet his reply cannot be said to meet it.

Mr. Keynes proceeded with his argument, however, and in question 4474, still referring to the group B payments, he says, "If they are paid through another business then that business will pay the amount as part of its cost of production to individuals? Is that it?"

Here again Major Douglas' reply took a most curious form. He commenced by saying, "Yes, I quite understand the difficulty. The real weight to be attached to this undoubted statement of fact—as it stands it is simply a statement of obvious fact——" and then he proceeded to shift the ground

of the argument, and draw a distinction between trade credit and the firm's own credit.

The peculiar character of this reply might justify a slightly flippant comment; but, presumably, Major Douglas desires to be taken seriously. The object of the question, then, was to indicate that these payments in group B which the witness claimed were not distributed to individuals, *were* in fact distributed to individuals by the other organisations.

The significance of the question was that it disputed the truth of the contention regarding group B payments. How, then, could the contention be *undoubted*? That Major Douglas met the challenge by assuring Mr. Keynes that the disputed statement was "simply a statement of obvious fact" throws more light on the mind of the witness than it does upon the question in dispute.

As to the distinction which he endeavoured to make between trade credit and the firm's own credit, this had no real bearing on the matter, because the normal procedure would be, that payments to other organisations for raw materials, and replacements of various kinds, would be made out of the proceeds of the sale of previous manufactures.

The facts are, simply, that if a factory is putting a certain quantity of manufactured goods on to the market each month, it may be distributing to its work-people in July purchasing-power which will actually assist to buy goods which it manufactured in January. In the same month of July, the other organisations which contribute in various ways toward the manufacture of the final product, are distributing purchasing-power to individuals in

respect of the production of raw materials, or semi-manufactures, which may not be required for use until some months have elapsed ; while the manufacturers of plant and machinery are paying wages to their employees for work which will not produce any final result, in the form of a product which the public buys, for a still longer period.

The fact that, in a given month, the manufacturer of the final product, the producer of the raw materials, the electrical company supplying the power, the engineering firm supplying plant and machinery, the contractor building factories and workshops, and every other organisation contributing to the cost of the final product, are distributing, to individuals, payments in respect of final products coming on to the market at widely different periods does not alter the fact that the total of such payments made in any particular period is available to purchase the goods which are offered for sale during that period. Over the whole field of production, purchasing-power is constantly being distributed in respect of all the operations which have contributed to the cost of the article which the public buys, and Major Douglas' sweeping claim that only A payments are available as purchasing-power is totally unfounded.

Yet, in his reply to number 4477, he again says, " All the payments under group B are purchasing-power, which, if it was obtained by re-investment, was originally in the hands of the public, and never gets back into the hands of the public at all."

There is no qualified claim here. The contention is that none of the proceeds of re-investment, if used to make payments in group B, ever get back to the public. And if this is true of those group B payments which are obtained by re-investment, it must be true of all, for when the firms supplying raw material, or machinery, or power, receive cheques in payment, it is inconceivable that they should be influenced in their disposal of the money by any such consideration as whether their customer, the manufacturer, obtained it by the sale of his products, or by raising new capital.

The claim is, therefore, that all the payments which the manufacturer makes, other than the direct payments to his own employees and to himself or his partners, never get back to the public at all. Yet a moment's consideration should suffice to show the absurdity of such a claim.

Suppose that I am a boot-manufacturer, and I pay, this month, £1,000 to the tanner who supplies me with leather. That is a group B payment. Yet the tanner will use part of the £1,000 to pay the wages of his employees, and part of it he will pay to the people who sold him the hides, and in each case it comes back, eventually, into the hands of the public.

The same is true of the payments made to the power company, to the engineering firm, to the colliery company, to the transport company, to the builder, and to the municipal or revenue authorities. In all these cases some portion of the payment is passed on to individuals in the form of cash, and the remainder may be handed over by cheque to other organisations.

Major Douglas appears to imagine there is something sinister about the fact that a large portion of the money circulates in the form of book entries, without being translated physically into notes or coin. Yet this circumstance is merely the reflection of our modern methods of exchange ; methods which have made it possible for the banking system to circulate a vast volume of money, while only holding one tenth of the total amount in a physical form.

Evidently one bogey which is worrying Major Douglas is the cheque system. Imagine the abandonment of this system, and assume all payments to be made in cash, and a large proportion of the vast structure of credit would have to be given a physical form by issuing notes to cover it. Instead of drawing a cheque for £1,000, the manufacturer would draw, from his bank, notes to that amount, and pay them over to his creditor. It would be a tremendous inconvenience, but Major Douglas would be happy at last in knowing that the money was there.

For is not this largely his difficulty, that a great deal of the money in the money stream does not come to the surface in a physical form. If I am a manufacturer, I take from the stream what I require for my costs, and I return it in the payments which I make, and in so far as part of the money I have used returns to the banking system without first passing through the hands of the public, I am merely passing on, to another organisation, the duty of handing this particular portion of purchasing-power to the public.

It is true that I, the manufacturer, only distribute purchasing-power to cover the labour which my

factory has put into the product, for we may consider my profit as simply the proportion of the value of that labour which I appropriate to myself. The purchasing-power in respect of the labour involved in the various subsidiary processes is distributed by the subsidiary organisations employing that labour, and the total labour costs involved in the production of the article (including rent interest and profit, which are really charges on labour) form the price of the final article.

Now, if the consumer, whenever he bought a pair of boots, instead of paying one amount representing their total cost, paid the shopkeeper for his services, the manufacturer for his labour and profit, the tanner for his labour and profit, and so on through all the agencies which had contributed in some degree to the production of the boots, he would in the end be paying the same sum, but with a tremendous amount of trouble and inconvenience. To save this inconvenience he pays one amount to the shopkeeper, who keeps his profit and passes on the balance to the wholesaler, who again passes on the amount, less his profit, to the manufacturer, who retains his proportion and hands on the rest to the merchants and others with whom he deals, and so on through all the processes which have been concerned in the manufacture.

In the end, the price of the boots will have been distributed in payment for all the labour which has gone to their manufacture, and every fraction of the price will have come back to individuals as purchasing-power.

In question 4479, Mr. Keynes tries to overcome Major Douglas' difficulty by imagining that all the various organisations were united in a single firm. Such a firm would employ all the labour concerned in production, and consequently it would disburse all sums received from the public in payment for goods, by returning them to individuals in the form of wages, salaries, interest, or profits. The reply which Major Douglas gave indicated that he saw the force of the argument, and his objection on the score of a time lag is very unconvincing.

In dealing with question 4481, he returns to this point by saying, "There would be a considerable amount of money paid out in wages for delayed production, and your hypothesis assumes that the distributed costs of a given week are the total prices of the goods for sale in the same week."

This is quite true, but how does it disturb Mr. Keynes' argument? All wages and salaries paid out by the organisation would be returned in exchange for the products of previous manufacture, and the interval between the labour payments and the consumption of the final product would vary as between the different stages of production. For example, the smelter who deals with the iron ore, receives wages for producing the metal which may later be cast and fashioned into a machine which will finally produce manufactures for the public to buy. Although the interval between the payment of wages and the consumption of the product is comparatively short in the case of the factory hand;

longer in the case of the engineer ; longer still in the case of the moulder, and again longer in the case of the smelter, the total amount of purchasing-power distributed in any given period may still be adequate to purchase the goods coming on to the market in that same period.

In other words, although it is the fact that the wages and salaries paid out in respect of each of the stages of production of the articles at present on the market have already been spent, the process of payment of wages and salaries in advance is *continuous*, and consequently the public holds, at any time, an amount of purchasing-power which tends to equal all payments made to individuals in respect of the production of articles then on the market.

The individual who has to make purchases in a particular week will probably not have a fraction of the purchasing-power which was distributed during the production of the goods he buys, but this will not embarrass him so long as he has received his weekly wage in respect of future production. What might embarrass him is a rise in the price level which reduced the quantity of goods his wage would procure for him. Major Douglas' contention is that even though prices remained stable there would still be a shortage of purchasing-power.

In replying to Mr. Keynes' next question, the witness went so far as to admit that the difficulty would probably be diminished, and this admission is really destructive of his case. The change which was visualised—of bringing all productive organisations

together into one firm—was an administrative change, which could not correct, or even greatly modify, such a fundamental defect as he imagined to exist.

What the illustration really did was to shake Major Douglas' confidence in his theory that group B payments are not made available as purchasing-power.

By his reference, in question 4484, to a revolving fund, Mr. Keynes had in mind, presumably, the transfers between one organisation and another, and it has already been shown that the significance of such transfers is, that the responsibility of distributing certain sums to individuals, is passed from one organisation to another. A whole sequence of transfers may be in respect of the same final product, and in some cases the amount transferred may be passed on with only a small deduction of profit ; but in the end, either directly or indirectly the whole of the price of the final product will have been distributed.

When Major Douglas says, " If the revolving fund is as large as the total amount of money required to finance the whole of all business, from the time the first process takes place to the time the article goes out to the consumer, it is possible—I should not be inclined to admit it offhand—that the question might disappear ; but that is certainly nothing like the case," he appears to suggest that the total amount of money required is the sum of all these transfers.

It is not very clear what Major Douglas really wants here, but if he means that there should be

enough money in existence to buy all the machinery of production, as well as the raw material and manufactured products, the answer is that surely his requirement is sufficiently met. Every piece of property with a price attached to it is owned by some individual or group of individuals, and if the owners so desired they could at any time turn their property into money.

The fact that the quantity of money available *in a physical form* is not sufficient to cover the whole of this property at existing prices is merely a reflection of the fact that at no time will more than a comparatively small proportion of the total be required in a physical form, and there is no reason whatever for supposing that the proportion kept by the banks in the form of cash is not sufficient to meet all the demands which will be made on them.

It is perfectly true, of course, that the purchasing-power distributed to consumers is inadequate to purchase all this property, but the consumers are not expected to buy the productive machinery as such, but only the final products which are from time to time produced, and the price of these goods is the sum of all the labour consumed in every stage of production, including that proportion of the labour involved in the production of buildings and plant, which is charged as depreciation.

The significance of question 4485 is that it states a case which would completely conform to the principle of equating purchasing-power to production. The questioner assumes a sufficient volume of

credit at the start, and then proposes to increase it in proportion as production increases.

This did not satisfy the witness, however, for he replied, " No ; there are all sorts of questions that would still arise. The question of turnover, depreciation, and the fact that the purchasing-power of credit, or whatever you like to call it, which has been transformed into price values of fixed assets in the industrial system would in existing circumstances have to enter into the cost of the goods——"

The reader will doubtless agree that lucidity is not Major Douglas' strong point, but in so far as his objection is that such items as profit and depreciation would be included in the price of goods, there is no substance in the objection. There is every reason why they should be included in the price charged to the consumer, because they are, on the reverse side, paid back to individuals. Profits, of course, are direct payments to individuals, while charges made on the consumer in respect of depreciation represent his payment for the portion of productive machinery which he has consumed, and the sums so paid are, in the process of making the replacements, paid back to individuals.

This question of the replacement of machinery and plant lost by depreciation was the subject of Mr. Keynes' next question (number 4486), in which he asks how the wastage of machinery differs from any other form of consumption. Major Douglas' reply—" Because you are not starting from zero. You are starting from a world as it is "—did not

throw a flood of light on the subject, but his next reply gave a new and interesting turn to the questions.

In number 4488 Mr. Keynes put the question, "Do you mean that the receipts of capital are greater than the amount it pays out in dividends?"

When the witness agreed that this was his contention, Professor Gregory took over the examination, and to his question, "What happens to the difference?" Major Douglas replied, "It is represented by the fixed assets in the company which it cannot distribute in the form of money."

His mistake, here, was that he was confining his attention to the assets which the company had obtained by the distribution of a part of its profit, and was overlooking the fact that the profit had been spent in order to obtain them. The company had, in fact, spent that portion of its profit which was allocated to capital expenditure in buying tools and machinery; just as the shareholders may have spent their dividends on motor-cars or furniture.

In question 4490, Professor Gregory asked, "If a company earns £100,000 in one year, and puts £50,000 towards increasing its plant, does not that £50,000 flow out in additional wage payments?"

This is obviously what does happen, because all additional production, whether of capital goods or consumers' goods, represents an expenditure of

labour for which wages have to be paid. It is surprising therefore to find that the witness replied, "No, that does not happen at all."

He then proceeded to explain that what really happens is that during the year it is necessary to create new tools or jigs, which must be charged in the cost of the product. But in what way does this explanation conflict with Professor Gregory's statement?

The question was simply whether money used for capital expenditure flows out to individuals in the form of wage payments. Major Douglas maintained that additions to plant are charged in the cost of goods. This is perfectly true, in as much as they are paid for out of profit, but it did not disturb Professor Gregory's claim, which is equally true.

The facts are, of course, that such capital expenditure is first charged in the cost of goods, as profit, and then returned to the public in payment for the labour expended in bringing the new plant or machinery into existence. All the consumer is interested in is that he pays, in the price of the goods he buys, certain items of cost, together with the firm's profit, and it is no concern of his whether this profit is distributed to individuals in the form of dividends or whether it is added to capital and distributed to individuals in the form of wages.

In either case it is taken from the public as a cost of production, and handed back to the public in the form of purchasing-power.

This position was quite clearly set out in question 4491, and the answer given shows a failure to appreciate the point which was remarkable. The example, which Major Douglas gave, of a company which shows a profit of £10,000 of which £8,000 is in fixed assets, did not in the least justify his denial, and when he said "it is quite obviously only distributing £2,000 out of £10,000 which appeared in prices," it is strange that he did not see that the really obvious circumstance was that the company had acquired the assets by distributing the £8,000.

Professor Gregory pointed this out quite convincingly in number 4493, but the result was only to draw from Major Douglas what was, perhaps, the most astonishing reply that the interrogation produced.

The facts were, indisputably, as Professor Gregory had stated, that the company had disposed of its £10,000 of profit by handing £2,000 to the shareholders and by causing the other £8,000 to be handed to individuals for making the assets. The position was precisely as though it had paid the whole £10,000 to its shareholders and then raised £8,000 of new capital in order to acquire the assets.

If Major Douglas could prove a fallacy here, he must have revised the principles of logic, or perhaps it would be more correct to say that he had discarded them. The questioner's point had been, that the assets had not been distributed, but the £8,000 which paid for them had, and this £8,000, together

with the £2,000 paid to shareholders, made up the £10,000 of profit.

What justification, therefore, had Major Douglas for saying that, according to Professor Gregory's argument, the company would be distributing £10,000 more than it had made? And why £10,000 more, when in any case the amount in dispute was £8,000?

In his next reply (question 4494), Major Douglas actually accuses the questioner of doing the very thing which he himself was doing—jumping from the money to the goods. Such a criticism could not reasonably be applied to Professor Gregory, because he was concerned only with the money. It was Major Douglas who was at one moment talking about the profit the company had made, and then jumping to the goods which it had bought with that profit, in order to claim that it could not distribute them.

A comparable argument to that of the witness would be to say that if a shareholder had received £200 and used it to buy a car (an asset which, obviously, he could not spend), he had therefore received a dividend which he was unable to spend.

Not content with jumping from the money to the goods, however, Major Douglas continued his mental gymnastics by again jumping from £8,000 to £10,000. Finally, he draws an analogy between the point at issue and the case of a man who has received a legacy of 30,000 acres of land, upon which he has to pay £10,000 in death duties.

The only point here is that the man in question has inherited £30,000, which, however, the previous owner had invested in land. The new owner receives the value of £30,000 in real estate, but out of this the State claims £10,000. He has, in consequence, to dispose of 10,000 acres of land in order to pay the portion of his legacy which is due to the State.

There is, perhaps, a difficulty here for the legatee, in so far as he may have to sell in an unfavourable market, but the case has not the remotest connection with the matter under discussion.

With question 4496, the Chairman again took over the task of interrogation, and restated the facts with regard to the company which was assumed to have utilised £8,000 of its profits for the purpose of increasing its assets.

Major Douglas made the not very adequate reply, "Yes, I quite realise the difficulty ; I felt this would arise."

He then proposed to read from an article which he had previously written, and his extract is given under number 4498. The illustration contained in this article concerns the building of a house at a cost of £1,000, and the sale of the house, when completed, to the workmen who had built it.

Major Douglas had prefaced his explanation by saying that it was the shortest form in which the statement could be put. One wonders, therefore, why he had not thought of condensing it by simply

stating that the workmen had saved £1,000 out of their wages and used that £1,000 to buy a house.

For, baldly stated, this was the position at which he had arrived, and the preliminaries served no purpose except to obscure the issue.

But, to proceed with the illustration, the Committee were told that the workmen, having saved £1,000 of their wages and invested it in a house, now decide to use the house as a shoe-factory. Incidentally, the suggestion made at this point, that it could be supposed that the money was destroyed, and that this would be the equivalent of the repayment of a bank loan, is an entirely false assumption.

The repayment of a bank loan simply leads to the cancellation of the entry in the books of the bank. As a result the bank has the amount of the loan to lend to a new borrower, because the volume of its loans are determined by the amount of its cash, and the cancellation of a loan leaves its cash intact.

Continuing his recital, Major Douglas explained that the shoes, when made and placed on the market, have to bear in their cost an amount on account of depreciation of the factory. To quote his own words, "the simple and vital fact remains that the wages paid during the production of the shoes are less than the price of the shoes by an amount, large or small, which is added to the cost of the shoes before the shoes are sold, representing, at least, depreciation."

Now let us see what we have in this illustration. In the first instance the workmen sold their labour for the sum of £1,000 in wages and with this £1,000, they could, if they chose, acquire, say, 1,000 pairs

of shoes, assuming the price to be £1 per pair. But instead of using their wages to obtain final products, they buy the means of producing shoes.

Let us assume, for the sake of the argument, that the factory which they have acquired with the £1,000 will enable them to produce 10,000 pairs of shoes, and it follows, therefore, that every time the public buys a pair of shoes, it is liable to pay for the labour expended in manufacturing them, plus one ten thousandth part of the labour employed in building the factory. The public are, therefore, merely paying for the proportion of the factory which they consume in the shoes they buy, and when 10,000 pairs of shoes have been manufactured and sold, and the factory has depreciated to nothing, the men will have received back the £1,000 which they earned in the first instance.

They may now buy the 1,000 pairs of shoes which they had the right to buy at the start, or, if they prefer it, they may again use it as capital, and buy another house.

For the whole significance of this £1,000 is that it gives, to the workmen, the right to consume labour in return for the labour they have supplied. If they had bought 1,000 pairs of shoes and consumed them in the first place, that would have ended the matter for them, but because they bought, not a final product, but something which the public consumes in the final products it buys, the public has to pay back to them the cost of the factory, so that the workmen may have their right to the consumption of £1,000 worth of goods restored to them.

But, Major Douglas would say, the purchasers of shoes have a new charge to include in the cost of their shoes, and no additional money with which to meet it.

Such a plea is quite groundless. If the use of a factory is a new departure in shoe production, it will have been resorted to because it constitutes an economy in the process of manufacture, and the consumers will, in future, be getting more shoes, or cheaper shoes, as a result. If on the other hand it is the usual method of manufacture, there will be a steady, or possibly an increasing, rate of production of shoe-factories, and the wages which are paid to workmen for building new factories will equal, or exceed, the amounts which consumers are paying on account of depreciation of shoe-factories.

At this point, Mr. Keynes enquired (question 4499), "By whom are the overhead charges paid?"

In his reply, Major Douglas was apparently contending that, although the cost of the factory was now appearing in the price of the shoes, it had been paid in previous cycles of production. He makes this claim more definitely, in reply to Mr. Tulloch, when he says, "the whole cost of the house was previously paid."

Doubtless the point which he was endeavouring to make was that the consumer was paying a second time for the factory. But in what sense was it previously paid? The £1,000 had been paid to the workmen in the form of wages—but that was a payment *to* consumers for having created the factory,

and in any case it was cancelled by their purchase of the factory with the wages.

The position now was that they had built the factory, but had not yet been paid for their labour. Their wages were in the value of the factory and whoever consumed it would need to pay the workmen the wages which they had exchanged for the factory.

Number 4501 shows the witness continuing his illustration by asking the Committee to suppose that the same £1,000 is used to build a second house, and that, as before, the workmen buy back the house with the wages they have earned. The final result, he points out, would be that assets valued at £2,000 would have been created, and £2,000 would have to be collected from prices, although only £1,000 of money had been used.

Actually Major Douglas might have assumed that the workmen built the houses in their spare time and so left all question of money out of the transaction. Since he assumed that the material would be obtained for nothing, and that the workmen would be able to support themselves without touching any portion of the wages which they received for house-building, no money was necessary.

If he had wished to condense his explanation into the smallest possible compass, all he needed to do was to suppose that a number of people, by working in their spare time, had created assets which they could, if they chose, sell for £2,000, and which might be used for the production of shoes.

There is, indeed, no more in this illustration than an example of labour being used in the production of capital goods ; goods, that is, which are held as capital by certain individuals, and which the consuming public do not buy directly, but pay for (in the form of depreciation) in the price of final products.

At the same time, there is a point here which, at first sight, may appear to support Major Douglas' theories. The workmen in the example, have increased the capacity for shoe production by using their labour to create a shoe-factory. In other words they have saved the wages which they earned by building, and have invested the sum saved in a shoe-manufacturing business. As a result the number of pairs of shoes coming on to the market will be increased, and if the amount of money in circulation remains the same, either more money will be spent on shoes, and less on some other commodity, or the same total amount of money will be spent on shoes at a lower price per pair.

Since the expansion of production is general, and continuous, and proceeds—or could proceed—at a greater rate than currencies have been allowed to expand in the past, there has been a tendency for such expansion of production to become effective through a falling price level, and to the extent to which the increased production results from an actual cheapening of the productive process, this would, ultimately, be an accurate reflection of the change which had taken place.

Yet the process is likely to be a painful one for industry, for when prices fall, holders of stocks of

goods find part of their value melting away, and if the fall is considerable, their profit, and perhaps a part of their capital, will have disappeared. For this reason, much potential cheapening of production is not allowed to become effective, or is slowed down to a rate to which industry can accommodate itself.

Probably a good deal of the support which Major Douglas has received is due to his insistence on the fact that technological improvement is making possible an ever-increasing volume of production, and his claim that this potential expansion is stifled, through the inability of the public to buy the goods which are produced.

Yet it would be a mistake to suppose that Major Douglas' proposals merely aim at causing purchasing-power to step up in time with production. Such a result could be achieved without recourse to his plan ; added to which is the fact that his evidence leaves no room for doubt that his proposals go very much deeper, and are based upon his assumption of an inherent and recurrent shortage of purchasing-power.

Although it may be admitted, therefore, that the illustration of the workmen building houses, and then using them for the purpose of production, may indicate a need for a gradual increase in the supply of money, so as to finance new production, it does not bring the witness a fraction nearer to proving his main point. That point was that, quite apart from the question of expansion, the economic system is continuously passing out to the public an amount of purchasing-power which is totally inadequate to

buy the goods which are offered to it in the same period.

Judged in the light of subsequent events, the few questions dealing with the gold standard seem rather remote from the real issue. Yet in May 1930 there seemed to be little prospect of this country going off gold, and the point had an importance then, which it does not now possess.

Arising out of Major Douglas' claim that it is possible to make any relation between purchasing-power and prices that is desired, Mr. Brand asked, in question 4509, " You mean you can at the same time increase purchasing-power and lower prices ? "

The reply—" Undoubtedly ! without the slightest doubt "—is the more remarkable when it is remembered that the witness had at the outset laid it down that the ordinary effect of increasing purchasing-power is to raise prices.

Professor Gregory reminded him of this fact in number 4511, and then went on to say, " The whole of the validity of your argument turns on the effectiveness of your method or methods of subvention, or subsidy, or whatever you care to call it ? Is not that so ? "

Major Douglas denied this, and then went on to repeat his curious defensive tactic, of disclaiming any intention to put forward a specific scheme, and

took his stand on general principles which could readily be subscribed to by many people who dissented entirely from his particular credit proposals.

In questions 4512 and 4513, Mr. Brand enquired if the remedy for lack of effective demand is to give all the population plenty of money, regardless of whether they are producing.

The witness intimated that he would not be inclined to dispute this.

A little later the Chairman asked (number 4515), " Would not the industrial system soon cease to operate ? "

Major Douglas' retort—" It is not operating very well just now "—although quite true, missed the Chairman's point, which was that if a sufficiency of purchasing-power is supplied to everyone, without demanding of them an equivalent return, it will be no one's business to keep the productive machinery running.

The same point was again put by the Chairman in question 4516, and in his reply the witness agreed that an incentive to produce is necessary to the working of any monetary system.

Number 4518 again brought Professor Gregory into the arena with a restatement in practical terms

of Major Douglas' proposals. He was met at the outset, however, by the objection, "I have not put forward a scheme."

Surely the witness was being needlessly cautious here. Any supporter of Major Douglas would most certainly claim that he has a scheme, and a completely worked out and elaborated scheme, and when the request was made, by his supporters, that the Committee should call him as a witness, it was undoubtedly with the object of permitting him to advance his particular proposals. Not only was this his presumed object, but the Committee were apparently under the impression that they had been discussing the plan which he had come to explain to them.

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Professor Gregory was able to overcome the objection, however, by substituting "suggestion" for "scheme," and proceeded to ask (question 4519) for how long the Bank of England would continue to issue the credits.

The reply which Major Douglas gave was a complete *volte-face* on that which he had made immediately before. He had just denied that he had put forward a scheme, and then in his very next reply he claims that he has already elaborated the basis.

Elaborated the basis of what? Was it of the scheme which he had never put forward?

. . . .

A little later, in question 4523, Professor Gregory asked, "Supposing you could only get a continuous

utilisation of full productive capacity at the expense of rising prices; which would you choose?"

To this Major Douglas replied, "That is an important question. Would you mind repeating it?"

. . . .

Professor Gregory repeated the question almost in the same words, and received the reply, "Well, I should not admit that that was the dilemma."

. . . .

But the questioner persisted, pointing out that it might be the dilemma, and then continued, "It is possible to hold the view that it is desirable to increase the volume of purchasing-power even though it involves raising prices. I ask you, supposing your own principles are wrong, but that there is something in the idea of expansion of purchasing-power, which would you choose?"

The character of the reply to this question, which, when it was first formulated, Major Douglas described as "an important question," was such as to draw from Professor Gregory the comment, "You do not want to answer?"

To this the witness replied, "I do not want to answer. I do not think it is a necessary state of affairs."

We are left wondering just in what sense the question was an important one.

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After a few questions relating to banking conditions in America, Mr. Lubbock, in number 4532,

returned to the illustration of the purchase of a motor-car.

Continuing, he asked (number 4533), " Would you allow the Treasury to print notes and issue them to the bank, and the person with the credit to get them from the bank ? "

To this Major Douglas replied, " If it were required. Of course, the number of notes required would depend upon the volume of business which was conducted."

. . . .

To make the point perfectly clear, the questioner restated it as follows : " I, having that credit in the bank, might wish to withdraw notes from the bank to make a purchase ? "

He received the reply, " If you wanted, you could have the notes."

In question 4535, Mr. Lubbock goes on to point out that in effect he would have bought the car for £75 of his own money and £25 supplied by the Treasury. This was the same question which had been put, earlier, by the Chairman, and to which Major Douglas had then taken exception.

In this instance, however, he readily agreed.

. . . .

Mr. Lubbock then went on to enquire whether the same system would apply to other purchases ; of bread, for example.

Here again, the witness did not desire too much insistence on the particular form of mechanism which he had suggested.

The questioner's reminder that it was desirable to bring the matter down to concrete fact prevailed upon the witness to face the logical consequences of his proposals, and in number 4537 he admitted that the issue of credits in respect of one particular commodity would cause the prices of other commodities to rise.

He confirmed this, in his answer to the next question, by saying, " There would be a rise in price in the ones to which the scheme did not apply."

Following up the point, Mr. Lubbock asked, in number 4539, " You would gradually extend it ? " and received the reply, " Yes. The ultimate general result would be that you would be applying a certain proportion of credit—and by hypothesis increasing the credit of the country—to a reduction of the price level."

It would be difficult to compress more inaccuracies and false reasoning into any paragraph of the same size, than Major Douglas has got into this one.

In the first place, two blacks cannot make a white, and if, upon his own admission, an issue of credit to one commodity has the effect of causing a rise of price elsewhere, a repetition of the same process cannot neutralise it, but will, in fact, add to the rise. His initial mistake lies in his assumption that the first credit actually has the effect of reducing the price of the motor-car. In reality it does nothing of the kind.

As we found in discussing an earlier question, the

proposed credit would merely assist the consumer to make a particular purchase at the existing price, and since the method would be to give him new money, which he would immediately put into circulation, the ultimate effect would be to raise the general price level. Major Douglas can no more effect a fall in the price level by increasing the amount of money than he can empty a vessel by adding to its contents.

As for his interpolation—" by hypothesis increasing the credit of the country "—the assumption here is equally fallacious. The effect of unlimited financial credit is to *decrease* the real credit of a country, as all governments following an inflationary policy discover to their cost.

It was evidently the significance of Major Douglas' admission that prices in other industries would rise which led Mr. Lubbock to underline it in his question 4540, and when the witness confirmed it, the questioner went on to ask—" Would they come down again ? "

The reply—" No ; you would apply the question of reducing prices to them "—indicates a faith in his theories which is admirable only in its simplicity.

According to Major Douglas, the credit given to the purchaser of a motor-car would cause prices to rise against the consumers of other commodities, but the motor industry would be protected. He admits that the prices, once raised, would not come down again of themselves, but says that the same process would be applied to them in turn. But since

the price had first been raised, a larger credit would be required for the second article than was given to the first, if the second consumer was to get the same measure of relief.

Now the effect of this second credit would obviously be the same as the first, and so, still according to Major Douglas' argument, prices in industries outside would be raised by the second credit, just as they had been by the first. For this is the difficulty in which his admission had involved him. The relief given to one industry would only be obtained at the expense of others, and he could only extricate more industries by increasing the load upon those remaining outside.

If we assume that credits would be given to 50 per cent of the industries, prices in the remainder would be increased in respect of each of the credits given. If the credits were then extended so as to cover, and protect, 75 per cent of the industries, prices in the remaining 25 per cent would soar higher still, because they were being affected by the credits given to 75 per cent. When, eventually, the process had been extended so as to embrace all but one industry, the only logical inference—assuming Major Douglas to be correct in his claim that his process effected a lowering of the price level in those industries to which it was applied—is, that the increase in price in the one industry left outside would be multiplied by all the credits given to the rest.

Major Douglas' solution of this difficulty is to give the credits to all, and with a faith that would move mountains, he believes that if he repeats his process a sufficient number of times, the effect will disappear.

Here again, his initial mistake is that he believes he is able to lower the price level in the industries subjected to his method, and it follows that he presumes they would be protected from a rise in price which affected industries outside the arrangement. The reality is that the credits, as soon as they got into general circulation, would raise *all* prices, including those in the industry which had received them, and each succeeding issue of credit would need to be increased in amount, in order to overtake the increase in price resulting from the whole of the previous credits.

So the method stands revealed as inflation at its worst ; swelling to wider proportions at each successive attempt to overtake by a greater folly the evil effects of the follies of the past.

In this fact, that Major Douglas' method is simply to distribute more money, which must have an effect on future prices, lies a complete disproof of his theories.

We have seen, in connection with earlier questions, that he bases his whole case on the claim that the consumer is never supplied with sufficient purchasing-power to buy the goods which he is expected to buy. The claim is axiomatic with him, and his proposals are directed solely towards making good such a deficiency.

If, therefore, his method can do no more than distribute new money, which, as soon as it is in circulation, will react on prices, his deficiency will recur perpetually, and the method will be entirely ineffective.

. . . .

In question 4542, Mr. Lubbock pointed out that prices could not be reduced by Major Douglas' method ; that he could only give a rebate to enable a purchaser to buy, and that on his own hypothesis the price had already been raised.

To this the witness replied, " No ; the price has been raised according to the second canon of the price system which is, that the price of an article is what it will fetch ; that is why the prices have risen ; but the first canon is the one to which the subsidy is applied, that it to say, the cost of production, and the cost of production of those articles would not necessarily have risen."

In other words, Major Douglas admits that prices have risen because the amount of money has been increased : for this is really what he means when he says, " the price has been raised according to the second canon of the price system—that the price of an article is what it will fetch."

Prices have risen, in fact, because money has become cheaper, and this cheapening of money must affect every purchase and will, inevitably, unless offset by some contrary factor, increase all future costs of production.

. . . .

Driven to admit that his system of credits, when applied to certain industries, would react on prices, Major Douglas tried to escape from his difficulty by suggesting, in his reply to question 4543, that it might apply to all commodities right away, and he went on to say, " You could apply the credit appropriation to the selling of those

commodities at that percentage of the cost of production."

In other words, to sell one commodity under cost by means of an issue of credit to the purchasers of that commodity, would throw a portion of its cost on to all other articles by increasing their price, therefore the way out of the difficulty is to *sell all commodities under cost.*

Presumably, if Major Douglas were Chancellor of the Exchequer, and put his principles into operation by paying, "out of the credit of the country," say, £4 per week to every unemployed person, he would argue that by doing so he had reduced the price of the goods they purchased by 100 per cent. When, later, he found that the effect of putting this new money into circulation had been to raise prices, "according to the second canon of the price system," he would apply an issue of credit to the cost of production of all articles and, "according to the first canon of the price system," would reduce their price by 100 per cent. The whole public would then be getting its goods free.

Apart from the substitution of 100 per cent reduction for the suggested 25 per cent reduction—an alteration of degree and not of principle—this illustration merely applies Major Douglas' argument in such a manner as to expose the absurdity in which his proposals had involved him.

. . . .

Finally, Mr. Lubbock asked, in question 4544, "That would not apply to my loaf of bread?" and received the reply, "Yes, it would."

The witness offered no explanation as to how the arrangement would be operated in the case of such small transactions as the purchase of a loaf of bread, or how he proposed to distribute the credits to wage earners with no banking accounts, and at this point the examination terminated.

CHAPTER V

FIRST PRINCIPLES

IN EXAMINING the evidence given by Major Douglas before the Macmillan Committee, it has not been difficult to detect the illogicalities in the contentions which he made and the arguments with which he endeavoured to support them. Yet it might perhaps be claimed that the theory of Social Credit does not rest upon the testimony of one person, even though that person be its originator.

The witness may not have done himself justice, and for some reason may not have presented his case as it might have been presented. Such a claim would suffer from the fact that the dilemma in which Major Douglas frequently found himself was obviously inescapable, and it is not conceivable that another witness, any more than he, could achieve the impossible.

It is a sound criticism, however, that the disproof of a theory must be positive in the sense that it dissects the theory itself and uncovers the fallacy contained therein. In setting out to do this, it will prove of advantage if we first arrive at a clear understanding of what we mean by certain general terms to which we shall have occasion to refer.

WEALTH

There is probably no subject about which more misunderstanding exists than about the subject of the creation and distribution of wealth. The popular belief is that money is wealth, yet this is a complete fallacy.

Wealth consists in material possessions, and in the ability to render useful service, and money, in either of the forms in which it may exist to-day, is no more than a measure of value. A moment's reflection will show this to be the case, for the value of money is in what it will buy, and it need have no intrinsic value.

Place a man in a city, with a cheque-book in his pocket, and £100,000 standing to his credit at his bank, and all the resources of the city are at his command. Place him on a desert island with his cheque-book in his pocket, or with the £100,000 in notes by his side, and he is as poor as any beggar in the streets of the city. For money is simply a claim on services, goods and possessions, and its value consists in the ability of the community to honour it.

Land is the primary wealth, and all other wealth which has a tangible form or substance derives in some degree from natural resources. But the most valuable possessions are much more than products of nature. Their value may consist almost entirely in the labour and ingenuity which have gone to their production.

The wealth of a community may be said, therefore, to contain two elements—natural products on the one hand, and human labour on the other hand —and of these two elements, the latter, in an

industrialised community, is by far the greater and more important.

A valuable piece of furniture is much more than the timber from which it was made. Indeed the wood may be said to have been valueless until the tree was felled and sawn, and even from that point the material may account for only an insignificant part of the value of the finished article. On the other hand, the labour element accounts for the whole of its production from the raw materials and, in addition, the preparation, and possibly the production, of the raw materials.

This does not mean that the labour content is necessarily the actual amount of manual labour involved in the production of a particular article ; many articles, because of their scarcity or great desirability, acquire a greater labour value. For example, the diamond may be obtained with a smaller expenditure of labour than a lump of coal, and yet it is worth a great deal more.

We might express this by saying, that, because of its rarity and desirability, a diamond valued at £100, acquires an exchange value equal to £100 worth of coal or wheat, so that it does really contain, in its exchange value, a labour content equal to that contained in £100 worth of some primary commodity.

All products of nature, and all human labour, are not necessarily wealth, however. Land may be barren or inaccessible, and a crop of weeds may destroy wealth instead of adding to it. Neither is labour always productive of wealth. A hundred men employed for a week digging holes and filling them

in again, will have produced no wealth, yet one man hoeing a turnip field for a day, will have helped to create wealth.

The natural product, or the labour, or the combination of both, must have the quality of usefulness or desirability, before it becomes wealth.

Even this does not give us a complete definition of wealth, for the air we breathe is useful and necessary but it is not wealth, because the poorest individual may have an unlimited supply of it. Wealth must not only be useful, its supply must also be limited, and in addition it must be capable of being transferred from one person to another.

Anything possessing these three qualities is wealth, and all wealth, when examined, will be found to consist of one or other, or both, of the two elements, natural resources, and human labour.

The more highly industrialised a community becomes, the greater is the labour content of its wealth as compared with the natural product element ; and this is true even though the actual period of manual labour is shortened by technological improvements. The modern motor-car may be produced in less time, and with a smaller expenditure of manual labour than the primitive carriage, yet the concentrated labour content of the former is greater than that of the latter, in so much as it is farther removed from a simple natural product, and more the product of useful adaptation.

As our mode of life becomes more and more complex, the natural products which we use are subjected to an increasing degree of adaptation in order to extract from them a greater service. This

greater degree of adaptation may be viewed as an increase in the labour content, although the labour may be in a more concentrated form.

Having clearly in mind that wealth is not money, but goods, and the means of producing them, and that this wealth is the product of natural resources, plus human labour and ingenuity applied to useful ends, we may now proceed to examine the principal forms which wealth takes.

FINAL PRODUCTS

The physical need of mankind is to consume. Human beings must have food, clothing, and shelter, and man's conquest of his environment has brought within his reach innumerable additions to his comfort, happiness, and well being. The satisfaction of all these needs and desires comes through consumption.

The food we eat ; the clothes we wear ; the house we live in ; the car which carries us from place to place ; the books we read ; the railway train or ocean liner in which we travel, all are being consumed. The process of consumption may be rapid, as with the food we eat or the coal we burn, or it may be slow as in the case of the house in which we live. But whatever may be the rate of consumption, the wastage is going on, and everything we use we are consuming.

The production of wealth is the means by which we satisfy this desire to consume, and the ultimate form of all wealth is a final product which is consumed directly by individuals. If I buy a suit of clothes and wear it, I am consuming a final product,

and equally if I build a house and live in it, or if some philanthropist builds a church or a library for the use of the public, each is a final product in process of being consumed.

We may define a final product, therefore, as anything which is consumed by an individual or group of individuals for the direct satisfaction of their own needs or desires.

CAPITAL GOODS

Although the ultimate form of all wealth is a final product, to be consumed in the process of satisfying some material human need or desire, not all wealth which is consumed is in the form of a final product. The cotton spinner consumes raw cotton and, although at a much slower rate, he also consumes the machinery which turns the raw material into the woven fabric. The weaver consumes yarn, while the tailor consumes rolls of cloth ; the builder consumes bricks and timber, and the manufacturer consumes the factory.

In all these cases, the things which are being consumed are not final products, but capital goods.

We saw that a final product is something which is consumed by an individual or group of individuals in direct satisfaction of their own needs or desires, but when the manufacturer consumes his raw materials and his machinery, he is doing so, not directly for the satisfaction of his own personal need, but in order to make a profit by providing the final products for other people to consume.

Many things, of course, are raw material for some

purposes, and final products for others. Coal is a final product to the housewife, but it is raw material to the gas or power company. The question is one which depends, not so much upon the character of the material itself, as upon the use to which it is put. If it is used to serve an individual human need or desire, it is consumed as a final product; if it is used in some industrial process in connection with the production of an article or the rendering of a service which the public will finally buy, it is consumed as capital goods on behalf of an ultimate consumer in the expectation that such ultimate consumer will reimburse the user of the capital goods.

If we keep this distinction clearly in mind we shall have no difficulty in distinguishing between final products and capital goods. We shall recognise as a final product anything which is consumed for the satisfaction which its consumption gives to the consumer, while we shall view the consumption of raw materials, semi-manufactures, power, machinery, or buildings, as service rendered to the ultimate consumer—service which he will be expected to return with interest in his payment for the goods.

A simple illustration may perhaps make this rather important distinction perfectly clear.

Let us suppose that I wish to have an additional cupboard in my house to add to its amenities. If I am a fairly expert amateur carpenter, I may decide to make it myself, and in that case I shall go to a timber merchant and purchase the material which I require for the purpose. That material will be, *for me*, a final product, because I shall consume it for my own personal satisfaction.

If, on the other hand, I do not feel able to undertake the job myself, and decide to commission a carpenter to construct the cupboard for me, he may go to the same timber merchant, and purchase the same material. But whereas in my case the timber was used as a final product, in the carpenter's case it will be capital goods, because he will only consume it in the sense that he uses it on my behalf as the ultimate consumer.

It is in fact paid for out of his working capital, and he has to pass the charge on to me in the price of the cupboard.

It will be seen quite clearly that the capital goods in this case represent a liability which the carpenter has incurred on my account and consequently I shall not complain when he charges me, in the price of the cupboard, a sum which will reward him for his labour and craftsmanship and also replace that portion of his working capital which he has expended on my behalf.

We may say then that by capital goods we mean all wealth which is held, not to satisfy the needs or desires of the holders, but in order to make a profit by satisfying the needs or desires of others. Within this definition we should include stocks of final products held for sale, and also raw materials, semi-manufactures, plant, machinery, and buildings, which are the materials for future production.

MONEY

We have just been considering the nature of material wealth and its various forms, and we come

now to a consideration of the means of distributing that wealth. Primitive peoples exchanged their cattle and grain and implements by barter, and this method of direct exchange is still resorted to in some parts of the world.

In all advanced communities, however, some form of money is used as a medium of exchange, and there is no doubt that the invention of money made possible the extraordinarily complex system of exchange of goods and services under which we live. By the use of money we are able to divide a direct exchange into two separate operations, sale and purchase; we are able to dispose of products, or obtain possession of things we need, without giving any attention to the other side of the transaction.

Money, at first, took a purely material form. It had to be something which, although small in bulk, had a stable value, and for this reason the precious metals had a special suitability. But as trade and commerce grew and material possessions increased, more gold and silver were needed to exchange the greater volume of goods. Gold in particular had become, in most places, the recognised standard money, and additional supplies were eagerly sought as the expansion of trade increased the demand for monetary gold.

It has previously been pointed out that money, as we now understand it, need have no intrinsic value, but this would not, of course, apply in the case of a community using gold and silver coins as its only medium of exchange. Such coins would be wealth as well as money so long as they had a commodity value in addition to their monetary value.

Such a monetary system would, in fact, be simply a form of barter ; a triangular barter, in which the commodity gold was always the middle factor.

It is important to notice here that in such a community, using gold as its sole medium of exchange, it would be necessary to maintain an equilibrium between the commodity gold and all other commodities combined.

The discovery of new gold deposits went some way toward meeting the increasing demand for money, but this alone could not have kept pace with the steadily increasing volume of trade. Some method of economising the use of gold was inevitable.

The introduction and growth of the banking system made such an economy possible. Banks were able to issue their acceptances, or acknowledgments, of sums of money deposited with them, and these acceptances began to circulate as money, and so long as there was public confidence in the ability and willingness of the banks to honour them, they carried all the authority of gold.

In the year 1690 banknotes were first issued by the Bank of Stockholm, and the practice soon spread to other countries. It continued in this country until the end of the eighteenth century, although English bankers were not forbidden to issue their own notes until the Bank Act of 1844. Since then, the Bank of England has been allowed virtually a monopoly of note issue in this country, and the Bank of England's note issue has been limited to the amount of its gold reserve, plus the fiduciary issue.

The withdrawal, from the English banks, of the right to issue their own notes was offset, however,

by the rapid extension of the cheque system, which has reduced such a large proportion of business payments to mere book-keeping transactions—for which neither notes or coin are required—that the Joint Stock Banks are able, quite safely, to build up their deposits to about ten times the amount of their cash, including their balance at the Bank of England.

When it is remembered that the fiduciary issue, which stands at the present time at £260 millions, has no gold backing whatever, and that the Bank of England notes in active circulation—already diluted by this fiduciary issue—form the backing for ten times their volume in deposits, it will be realised how far we have got away from a purely metallic currency. Money is no longer wealth in the sense of having a commodity value equal to its monetary value; instead of being an exchange medium with an intrinsic value equal to that of the object bought or sold, it is merely an acknowledgment of a debt owed by the community to an individual.

We have seen that the use of money in the first instance amounted to a system of triangular barter. The primitive herdsman found that he was not bound to barter his ox for grain at a time when he had no need for grain. He could as an alternative barter it for a piece of gold which he knew he would be able, at any time he chose, to barter for another ox, or for grain, or for any other commodity which he might need.

The expansion of trade, which made necessary a volume of money far greater than could be provided by the one commodity, gold, led to the adoption

of an exchange medium with little or no intrinsic value. In other words, the middle factor in the act of triangular barter was dropped out, and the seller, in the interval before he became a buyer, held only the promise of the community to pay him goods or services equal in value to the goods or services he had sold.

From an early period in their industrial development the peoples of the world were blindly groping with the problem how to increase their money at the same rate that their total wealth expanded. If they had continued to employ a limited quantity of gold as the sole medium of exchange for an ever increasing quantity of goods, each ounce of gold would have had to cover a larger and larger volume of goods or services. The difficulty was overcome, not by economising the use of money, as is sometimes erroneously supposed, but by inventing other forms of money, and economising in the use of money in a purely physical form.

Although it is a common practice to treat the term " money " as covering only the circulating medium, consisting of notes and coin, this view is, in the opinion of the writer, responsible for much confusion of thought. The correct view appears to be, that money is simply a title to goods and services, and the total amount of all money must equal all the goods and services priced with it.

The fact that the notes which I pay away for goods this week may return to me in wages next week, and serve for another series of purchases, is merely an illustration of the fact that we use physical money as representative money, and we are able to do this

because our practice of keeping money in banks has made it possible to make a tremendous number of payments without the use of any physical tokens.

If I write a cheque for £5 and pay it to a tradesman, that involves a payment of money, just as much as though I went to my bank, drew out the £5 in notes, and paid them over to my creditor. What happens is that I save myself the trouble of drawing out that £5 in cash, and save the tradesman the trouble of paying it in again, by simply writing a note to my banker instructing him to take £5 from the pile of notes which he has belonging to me, and add them to the pile of notes which he has, belonging to my creditor.

So far as I am concerned, this might be precisely what he does.

If the banker holds £100 of my money, I know that I can go to him and demand £100 in notes and he will give them to me ; or that if I instruct him to transfer any portion of those notes to other persons he will do so, and secure in that belief I am content to leave the matter in his hands.

But the banker knows quite well that I, and all his other customers, will save ourselves as much trouble as possible, and that in consequence nine-tenths of all our money will be continually in his bank, merely circulating amongst the accounts of his numerous customers. Banking practice has grown to reflect this fact, and when, from time to time, the banking system has increased the volume of money, only the proportion which experience has shown to be necessary has been in a physical form.

If we try to imagine, for a moment, that the

system of banking had never been invented, and that every payment was made by the transfer of physical money, we may get a clearer idea of what is really the position.

Under such conditions actual physical money would be paid out in wages, salaries, profits, interest or rent, in respect of every productive process, and if for the sake of the argument we assume stability the total of all these payments would equal the prices of all final products and capital goods.

Now all this money would be paid back only as final products, or capital goods, were consumed, and since the consumption of capital goods would be spread over a long period, the money paid out in respect of their production would only be paid back at the rate of their depreciation. Some persons would be holding stocks of goods, and stocks of material for the making of goods, while other persons would be holding stocks of money, and the total amount of money held as stock would be sufficient to purchase the whole of the material stock held by the other class of stockholder.

It will be seen, therefore, that if all money was in a physical form, the portion corresponding to capital would be, for the most part, immobilised, and if, with such a condition existing, we could assume a banking system merely for safe custody, it would follow that only a small part of the money would need to be in circulation and the rest would lie idle in the vaults of the bank.

In other words, every bank deposit, which at the present time can only theoretically be withdrawn in cash, could, in actual fact, be withdrawn in cash

on the same day, had it been found necessary or desirable to give all money a physical form.

A slightly imaginative, but none the less relevant illustration may help to an understanding of the point. We will suppose that a particular juvenile training establishment accommodates one hundred infant boys, all of the same age, and all so exactly alike that even their parents are not able to distinguish them. Each of the parents require to make periodical visits to inspect their offspring, and take them out of the establishment for the day, returning them to the charge of the principal in the evening. We will suppose that these visits occur at such regular intervals that the principal soon finds he can depend on not more than 10 per cent of the boys being required during any one day.

Now he has, as a matter of fact, only ten complete outfits, although he has been requested to accommodate, and has accepted, one hundred boys. If all the parents ever came for their children on the same day he would be in difficulties, for he could not send out more than ten at one time.

But as he is never asked for more than ten boys, and as any one of the boys will do for any one of the parents, he simply keeps ten boys fully dressed in readiness to be handed over to whichever parent may apply for them, and packs the remaining boys off to bed, where they remain quite comfortable in their night attire.

We may suppose that the parents, because they have perfect confidence in the principal, are quite contented, and actually get all they want, but some government inspector, or curious person interested

in the management of such institutions, discovers that there are only ten suits of clothes in the institution. He accordingly circularises the parents to the effect that he has made the discovery that only ten children exist, and that they are made to serve one hundred parents simply by the velocity of their movements. He may even elaborate his argument and explain that if the present velocity is doubled, so that each parent only retains the custody of his child for half a day, the number of children may be further reduced to five.

The parents are not likely to be greatly impressed by such an argument, and as long as they retain their confidence in the wisdom and honesty of the principal they will continue to believe that he still has their children in his charge and that they can take them out whenever they wish. And, after all, the arrangement will work quite well, for if there were really one hundred suits, only ten of them would be in use at one time and the other ninety would be lying idle.

The significance of this point, that we have discussed at some length, is that the need to add to the reservoir of money, in the same proportion that we add to the volume of goods, has never ceased to exist, and except for the fall in the price level which by default has resulted from increased production, the required additions to the monetary reservoir have actually been made. Had they not been made, the omission would have been reflected in subsequent prices, for it has never ceased to be true that prices of final products, and of capital goods, must reflect the relation between the total amount

of money and all the goods and services priced with that money.

Any change which has been made, therefore, has been in the *form* of the money, and not in the conditions which governed the quantity required in any given set of circumstances.

Our next task will be to examine the forms in which present-day money exists.

PHYSICAL MONEY

Only a comparatively small proportion of the vast total sum of money which our modern industrial system demands exists at any given time in a physical form. The silver and copper coins, and the notes, which we carry about in our pockets to meet day to day expenditure ; the money in shop tills ; the petty cash of business concerns, and the cash reserve of the banks, these constitute the only physical money, or circulating medium.

These coins and notes circulate between the banks and the public, and they represent merely that portion of the total amount of money which experience has shown to be necessary for circulation in this form. There is nothing absolute about the amount of this money, any more than there is about the proportion of my weekly expenditure which I find it necessary to carry about with me in the form of small change. It is simply a matter of convenience, and circumstances might conceivably alter so as to make it necessary to vary the proportion, which it bears at present, to the total volume of money.

If, for example, all wages and salaries were paid

twice weekly, a considerable portion of the sum paid out at mid-week would be back in the banks by the week-end, and the banks would find that their present proportion of cash to deposits was in excess of their requirements.

The point which it is necessary to make here is, that the amount of this physical money is only dictated by convenience, and that it constitutes only a part, and a comparatively small part, of the total volume of money. It is in fact representative money, and its so called " velocity " merely indicates the amount of work which the banker requires it to perform.

Just as the ten boys in the illustration acted as the representative of themselves and of the other ninety boys in turn, so a particular unit of representative money may be sent out to-day as a portion of Mr. Brown's account ; in a week's time as a part of Mr. Jones' account, and later still may be acting as the representative of part of Mr. Smith's account, and so on indefinitely.

CHEQUES AND BILLS OF EXCHANGE

Although some writers include cheques and bills of exchange in a general definition of money, such a view is not strictly accurate. At first sight this statement may appear inconsistent with what has previously been contended with regard to the wider application of the term " money," yet the correct view is that cheques, and bills of exchange, are assignments of money, but not money in themselves.

I can make out a cheque for any sum I choose,

but its value depends on whether I have a sufficient deposit with my banker, or alternatively whether he will advance me enough money to meet it. If I pass the cheque to a creditor, it is clear that I have not handed him money, because until he presents it, my bank balance will remain intact. Since the money cannot be in two places at once, and it undoubtedly remains in my account until the banker transfers it or pays it out, we must view the cheque, not as money, but as an authority given for the payment of money.

Bills of exchange are also assignments of money, but they are of a rather different character. By accepting a bill, the debtor promises to pay a particular sum of money, either on sight or at some specified future date, and if this bill is backed by one of the great banks or Acceptance Houses specialising in such business, it becomes a guaranteed promise to pay, which any bank will discount.

In other words the bank will undertake the responsibility of collecting the money and, pending its collection will loan the amount to the creditor, on the security of the bill. When the bill is finally paid, the holding banker will not hand the amount over to his client, but will retain it in cancellation of the loan. Although this procedure is not followed out in detail—the banker shortcircuiting the business by buying the bill, and charging his client, in the form of discount, the amount he would expect to earn upon the loan—the underlying implication is that money is lent for the period of the currency of the bill, and repaid when the bill matures.

It follows therefore that although the bill of

exchange is a negotiable instrument, which can be bought and sold as often as may be required, it is not money, but only an assignment of money. The banker holds it as security for the return of the money which he has invested in the bill, and when the money becomes due and is paid, the bill is cancelled.

It has been necessary to insist upon the fact that these two instruments of credit, cheques and bills of exchange, are not money, because it is important that we should get a very clear conception of what money is, and how much of it exists. We have already seen that notes and coins are not the only money, because there is no essential difference between payments by cheque and payments by cash ; but it is equally true that the volume of money cannot be measured by adding together all the coins, notes, cheques and bills of exchange, in existence at a given moment.

We know that the cash we circulate is money, but we know, too, that it is not the whole of money. Where then must we look for the rest ?

This question brings us to another aspect of the monentary problem, which it is essential we should thoroughly understand.

BANK CREDIT

When we say that the banks have the right to create credit, what precisely do we mean ? What is this credit which they create, and what are the conditions upon which they can bring it into existence ?

The deposits of the Joint Stock Banks consist of all

the sums standing to the credit of all their customers. They represent, in fact, the total liabilities of the banks to their clients.

On the assets side they require to have resources sufficient to cover the whole of these liabilities——plus, of course, their liabilities to their shareholders, and the sum which they have placed to reserve—and in the case of each of the great banks the distribution of their assets follows the same general arrangement.

The most important item on the assets side, and the one to which the bank pays the closest attention, is its cash. This item is kept closely to the proportion which the bank sets itself; a figure representing 10 or 11 per cent of its total deposits. The largest item on the assets side is that which represents advances to customers, and this varies from less than 50 per cent in some cases to nearly 60 per cent in others. The principal other items consist of Bills Discounted, about 15 per cent, Investments, about 12 per cent, and Money at Call in the Short Loan Market, about 7 per cent.

Now the point of great importance here is that all these items, with the exception of the first, are only approximately kept to their appropriate percentages. The bank aims at a certain percentage for each class of asset, but it allows itself a fair amount of latitude in order to adapt itself to changing conditions or requirements. Yet this latitude does not extend to its proportion of cash, which is, as nearly as possible, a fixed percentage. That is to say the bank adheres strictly to that proportion of cash to deposits which it believes to be dictated by banking experience.

Although the proportion of assets held in the form of Bills and Investments may vary considerably, the policy which determines their amount is a comparatively long term one. In the case of Advances, however, the variation may be from day to day, and it is necessary that there should be another equally liquid asset, which can be constantly adjusted so as to preserve the right relation between cash and deposits. This adjusting item is the Money on Call.

When the bank makes its daily review of its cash position, it may find, either that it has over-lent, or that it has a balance available for lending. If the former is the case, it calls in money from the Short Loan Market, and so reduces the volume of its deposits. If the latter is the position, it increases its short loans by handing a cheque, for the amount available, to a bill broker or a discount house, and increases total bank deposits by so doing.

It will be seen, therefore, that the factor which always determines the amount of a bank's deposits is the amount of its cash, and it follows therefore that, consequent on a particular amount of cash, there is an existing lending capacity. The business of the bank is to employ this lending capacity in the most profitable manner consistent with its obligations to its customers.

Now the significance of this is that the bank actually assumes the existence of an amount of money ten times as large as the amount of physical money, and operates up to the limit of this assumed quantity of money. A Joint Stock Bank with £300 millions of deposits, and £30 millions of cash, is really operating with £300 millions of money for

which purpose it holds £30 millions of cash as the physical representative.

No conception, other than this, really answers to all the facts, because neither the bank nor its customers can distinguish, in any practical sense, between money and bank credit. If I borrow £1,000 from a banker, I know that it consists, theoretically, of £100 of cash and £900 of what is called bank credit ; but since every pound has exactly the same value for me, and since I can draw just as much or as little as I wish in cash, the distinction has no meaning.

Incontestably, the belief I have that the whole of the £1,000 I have borrowed is money is the right one, and the fact that the banking system does not burden itself with physical money equal to 100 per cent of the money deposited is a reflection of the fact that the users of money do not want 100 per cent in the form of cash.

The point which it is desired to make here, very clearly and definitely, is that the attempt to distinguish between money and bank credit is both unnecessary and confusing. The whole of a bank's deposits are money, but, purely as a matter of mechanism, they are operated by means of a small proportion of physical money, acting in a representative capacity ; which proportion, experience has shown to be adequate.

Obviously, then, in so far as the bank creates anything at all, it creates money. It remains for us to examine what is the extent of its power to create this money.

We have already seen that the amount of deposits

which a bank carries is determined by the amount of cash it holds ; but the power to increase or decrease the volume of cash rests entirely with the Central Bank.

The Rt. Hon. R. McKenna, in the course of his address to the Annual General Meeting of the Midland Bank for the year 1931, used these words :

> " It is well recognised that the Bank of England, through the two instruments I have mentioned, has a high degree of control over the volume of credit and the rates currently charged for its use. Indeed, its control over the quantity of credit, and consequently of money, is as nearly absolute as anything can be in economic life."

The position is, then, that the Central Bank is the dictator of monetary policy and can either permit the banks to create more money, or can force them to contract it. If it decides on a policy of expansion it sets the pace, and the Joint Stock Banks carry that policy into effect. If, for example, the action of the Bank of England had the effect of increasing the cash reserves of each of the Joint Stock Banks by £1,000,000, they would each be in a position to build up their deposits by a further £9,000,000. In other words each bank would have been given authority to create £9,000,000 of new money which it would operate with a view to earning profits.

The original £1,000,000 would come to them in the form of cash paid in by their clients, and the bank would, of course, be liable to pay for the use of it. But the £9,000,000 which they, the banks,

would create would have an earning capacity for them, without carrying a similar commencing liability. There is a question here, therefore, which deserves very careful consideration; whether, when an increase in the volume of money is required, the Joint Stock Banks ought to be permitted to provide nine-tenths of that increase, and in so doing add to their earning capacity, *without undertaking the initial liability*.

Of course it is not suggested that the banks acquire a proprietory right over this new money, but only an administrative right. If, for example, the bank went out of business, it would have the disposal of its own capital and reserves, but could not retain any control over the money which, from time to time, it had been allowed to create. Such money would follow the cash against which it was created, and would swell the deposits of the remaining banks.

The point here is not an easy one to grasp, and yet it is one of very great importance, and a proper appreciation of it is essential to a correct understanding of the banking problem.

The mechanism of banking normally commences with the deposit of money by the public. The term "bank" was derived from *banco* or bench, and indicates a store or mount of money. The theory of banking is that the banker holds this store of money, on behalf of his clients, and employs what he may with safety, for the purpose of making his own profit.

Now whenever money is deposited with a bank, it places a liability on the bank, and the banker by using it balances this liability by an asset. The difference between the cost of the liability, and the

yield of the asset, is the banker's profit. In our illustration, the £1,000,000 which the Central Bank put into circulation was paid into the Joint Stock Bank by its various customers, and before the banker could use it he had to accept a liability to pay for it; but the £9,000,000 of bank credit which the addition to his cash permitted him to create he was able to use and put into circulation, without having been put to the expense of acquiring it in the first place.

We shall return to this question later, in order to discuss a possible alternative, which would be fair to the banks without being quixotically generous, and which in addition would have substantial advantages over the present unsatisfactory mechanism. At the moment, however, our particular concern is to show that bank credit is not a shadowy substitute for money, which is created and destroyed at the pleasure of the banker, but that, on the contrary, it is money in every essential particular, and exists continuously, so long as the cash which is its physical support remains in existence.

Money, then, is nothing less than the total of all bank deposits, plus the notes and coins which are in the pockets, the tills, or the safes, of all the members of the public. It has been issued to the public in the form of payment for all the labour and services involved in the production of all unconsumed capital goods and final products, and should, in total, be approximately equal to the sum of all their prices.

The system of distributing goods and services by means of token money—a system which has been forced on the world by the rapid growth of material

values—really means that the production of wealth normally involves the creation of two values: the material asset with its price on the one hand, and the monetary equivalent of that price on the other hand.

If I build a factory to replace one which has fallen out of use, I draw upon the existing store of money, by using my own bank deposit, or by borrowing from another depositor or from the bank. I pay this money over to individuals for building the factory, and they return the money in payment for final products, which they consume, and in doing so reduce the total wealth of the country by the value of the goods consumed.

If my factory cost £10,000, the final result will be that I shall have taken, from the stock of money, £10,000 which stood against the factory I am replacing, and paid it over to individuals for building the new factory. In the process I shall have put £10,000 of purchasing-power into the hands of consumers, and they will be free to use it to consume final products. The new production is therefore balanced by consumption. On the one hand I have produced an asset which is a contribution toward the production of future supplies of goods—a contribution which is valued at £10,000—and on the other hand I have enabled a number of people to consume goods to the same value.

In course of time my factory will in turn become obsolete, but I shall provide for this contingency, by placing to reserve a sufficient proportion of my profits to ensure that, when my factory is worn out, the money to replace it will be available. Even if I omit to do this, the capital fund would probably not suffer,

because there are always sufficient people saving part of their wages, salaries, or profits, and putting those savings into the capital fund, to compensate for any failure to maintain existing capital.

There is, however, another possibility. My factory may not be in the nature of a replacement ; it may be part of a general expansion of production. In this case I shall draw the £10,000 to build it from savings which are in excess of the sum required to maintain existing capital.

Now in these circumstances either of two things may happen. The Central Bank, aware of the expansion, may meet it by providing the necessary basis for an increase of money sufficient to finance the new development ; or, alternatively, the existing amount of money will adjust itself to the increased amount of material, and prices will fall in consequence.

BANK OVERDRAFTS

A considerable amount of banking business is concerned with overdrafts allowed by the banks to their customers. This type of business is usually preferred to straight loans, because it allows the customer to use just as much or as little of the authorised overdraft as he requires from time to time. His banker empowers him to overdraw his account up to a certain agreed amount, but the whole of this sum may never be required, and he pays only for the amount which he actually uses.

The point which it is necessary to make here is that these overdrafts are simply loans, the amount of

which is allowed to fluctuate according to the requirements of the borrower. Whatever part of the authorised overdraft is in use appears as a bank loan, and the payments which it enables the customer to make to his various creditors will come back to the banking system in the form of new deposits.

The repayment of the loan will necessitate the collection of sums from individuals, and the effect will be to reduce total deposits to the same extent that they had previously been increased by the loan. An overdraft only differs from a straight loan, therefore, in respect of the fact that, within the limits laid down, the borrower is allowed to determine its amount according to his requirements. In so far as it is used it represents an actual advance of money, and until it is repaid it absorbs part of the lending capacity of the bank.

VELOCITY OF MONEY

Before we leave this enquiry into the character and quantity of money, it will be well if we consider for a moment a matter to which a great deal of importance has been attached by some writers.

Reference has already been made to the "velocity theory," by which it is contended that the quantity of money required varies inversely to the velocity with which it is circulated. When it is remembered, however, that an increase in the velocity of a *given quantity of money* involves a corresponding increase in the rapidity with which goods are sold, it will be realised that the above theory requires some qualification.

If the quantity of money required is determined by the quantity of goods of all kinds available for consumption, it must follow that an increase in the velocity of money, coupled with an equal increase in the rapidity with which goods are consumed, cannot affect the *total amount of money* required, because for every £1 that is spent—at whatever rate—goods to the value of £1 will be exchanged. Yet it is claimed, in support of the "velocity theory," that an increase in the rate of circulation of money is equal to an increase in its volume ; and that such an increase in velocity may have the same effect as inflation.

The truth appears to be that a change in the velocity of money is merely a variation in the amount of work which physical, or representative, money is called upon to do. If the present physical money moved twice as quickly, half the quantity now in the possession of the public would be sufficient to do the work of circulating the present total volume of money. In consequence the banks would find themselves left with a larger reserve of cash.

If they reacted to this increase in their cash reserve by building up deposits to a figure nine or ten times as great as the new amount of cash, the result would be inflation. Yet it will be seen that the inflation would not have resulted from the greater velocity of money, but from the action of the bank in creating new money which was not authorised by any action initiated by the Central Bank.

We saw that the mechanism by which a policy of monetary expansion is made effective is that the Central Bank provides the physical basis, and the Joint Stock Banks build up deposits on this basis,

in their usual proportion. So long as the rate of circulation upon which this proportion is based remains the same, the process is automatic, and effective ; but any increase in the velocity of money ought to be followed by a withdrawal from circulation of the amount of physical money rendered superfluous by the greater representative capacity of the remainder.

The real position, therefore, is that an increase in the velocity of money cannot, of itself, produce inflation. It merely releases from circulation a part of the existing physical money—in respect of which the required amount of credit money has already been created—and this surplus ought to be withdrawn by the Central Bank, or alternatively, held by the Joint Stock Banks in excess of their normal proportion of cash to deposits.

It is incorrect, therefore, to say that the quantity of money required varies inversely to the velocity with which it is circulated. The correct statement would be that the quantity of *physical money* required to operate a given volume of money varies inversely to the rapidity of its circulation. In other words, the more work each pound note is made to do, the fewer pound notes will be required for the circulation of a given total volume of money.

This view supports the conception of money which we have offered as the only completely adequate one ; that the whole of bank deposits are money ; that some money is in use, and some in stock ; that purchasing-power available to buy final products is merely that proportion of the total which the holders of money desire, from time to time, to employ in

that manner; and that the total volume of money is sufficient to purchase, at one time, all final products awaiting sale or in process of manufacture, all raw materials and semi-manufactures, and all the machinery for future production, at its present value after allowing for depreciation.

In short, the whole of money would be approximately sufficient to purchase all unsold final products, and all material for the manufacture of future final products, since every cost of production has its origin in a money payment.

CHAPTER VI

FIVE DOUGLAS CREDIT FALLACIES

We have previously had occasion to refer to the fact that Major Douglas builds his case upon the assumption that an inherent and recurring deficiency of purchasing-power is involved in the present economic system. The assumption is, in fact, the basis of his whole position, and his A and B theorem is merely an attempt to demonstrate how such a deficiency arises.

He dissociates himself entirely from those criticisms of the present system which attack the evil of maldistribution, or which find an explanation of its failure to function adequately, in the subordination of production to the motive of private profit. The position he takes up is that there is room within the machine productive system for the full satisfaction of the needs of all consumers, without disturbing the present profit motive, and without limiting the right of individuals to accumulate demands on goods and services.

From his point of view, it is not a question of devising a more equitable distribution of the available purchasing-power, but rather of utilising an unappropriated part of production by means of a

distribution of new purchasing-power. In order to do this within the present profit system, it is necessary to discover some process by which additional demands on goods can be introduced without detracting from existing rights.

Major Douglas' method is to indicate a gap between the total prices of all consumers' goods and the total purchasing-power available to buy them, and then to propose to fill this gap with his " consumer's credits."

Having convinced himself of the existence of a gap, his second proposition—that it is possible to fill it by the distribution of a form of purchasing-power which will not produce the effect of inflation—is a natural deduction from the first. When we find him repeatedly insisting, in the face of every logical objection, that his process is obviously possible, he simply means that there must be a method of filling the gap, the existence of which he assumes to be established. He is, in fact, proof against all arguments which may be opposed to his method, because he never contemplates the possibility that no such gap exists.

But a difficulty arises here. If the present organisation of production involves the distribution of an amount of purchasing-power which is always less in volume than the total costs of the goods produced, how is this discrepancy adjusted so as to make a new cycle of production possible ?

Major Douglas meets this difficulty in two ways. First, by his insistence that it is the rate of flow of purchasing-power which governs the whole position, and that the rate of flow of purchasing-power is much

less than that of prices ; secondly, by his conception of financial credit as a costless, intangible, quantity, which the banks can expand or contract at will, without incurring any obligation to limit the amount of expansion or the amount of contraction, or to relate one to the other.

In some fashion, the details of which Major Douglas finds himself unable to explain intelligibly, the rate of flow, coupled with the flexibility of the credit issue system, is supposed to fill the gap between one cycle of production and another.

The producer is assumed to operate with the aid of bank credit, brought into existence for the period of his industrial process, and cancelled when the cycle is completed. The bank, in his view, floods the industrial system with financial credit for the purpose of launching each cycle of production, and draws off the credit when the process is complete. In this way he attempts to explain how it is possible continually to distribute, to the public, less than the cost of the articles produced.

Cost, he maintains, includes all payments made to individuals (wages, salaries, and dividends) and also payments made to other organisations (raw materials, bank charges, and other external costs). Of these—according to his argument—only wages, salaries and dividends become purchasing-power in the hands of individuals ; the remaining items of cost have been previously paid to individuals and returned to the banking system, and the payments now made are merely transfers from one organisation to another and do not represent purchasing-power in the hands of the public.

These " B " payments are therefore, in Major Douglas' view, payments to the banking system and not to the public, and, in consequence, that proportion of production which they represent can only be purchased out of bank credit. But the consumer cannot obtain bank credit in order to spend it on goods for *consumption*, and so the whole of the surplus which the public cannot buy must be used for export, or absorbed as a result of the issue of further credits for the purpose of creating additional capital goods.

Simply stated, it amounts to this : Major Douglas believes that industry distributes purchasing-power to the public equal to " A " costs, and makes payments to the banking system, through its payments to other organisations, on account of " B " costs, and that the purchasing-power distributed to the public, plus the payments to the banking system which do not pass viâ the public, would together be no more than adequate to purchase the available goods.

In his view, it follows that the banking system could, if it so desired, buy up the greater part of all production. But as it does not, as an institution, require to consume goods, it can only re-issue the credits for further capital production, or to finance exports.

If Major Douglas' contention means anything at all, it means that, for every article that is produced, the purchasing-power corresponding to " B " costs resides with, and is under the complete control of, the banking system. Consequently, that part of production which corresponds to " B " costs can

only be consumed by the public, if and when the banks issue credits, for capital production, of such an amount that the new "A" costs distributed will be sufficient to purchase the surplus production.

According to his theory, therefore, if "A" and "B" costs each accounted for 50 per cent of the price of all final products, every £100 worth of final products produced would be accompanied by the distribution of £50 of purchasing-power to the public and the payment of £50 of "B" costs to the bank. In order that the £50 worth of goods represented by the "B" costs might be consumed, the bank would then need to issue a further credit of £100 in respect of capital production, thus permitting another £50 of "A" costs to be distributed to the public.

It is probably such a process which Major Douglas has in mind when he insists that the present initiation of production by means of loan credit involves a continual lengthening of the lever of production, as the price, which the public has to pay, for the right to consume the goods already produced.

A further claim that Major Douglas makes is that the credits he proposes to issue would have the effect of lowering prices. This contention is his method of meeting the charge of inflation. He recognises that merely to increase the amount of money in circulation would cause a general rise in prices, and defeat the end in view, and therefore he claims, for his method, that it achieves its object by lowering prices.

We have here five claims, which constitute the material part of Major Douglas' case, and we shall find, in the case of each of them, that the argument

is built upon a fallacy. Before we proceed to examine them in detail, we may briefly restate these five propositions.

(1) That there is an inherent and continuous deficiency of purchasing-power consequent on the non-availability, as purchasing-power, of the whole of group " B " payments.

(2) That Consumers' Credits can be issued in such a form as not to produce inflation.

(3) That the rate of flow of purchasing-power is much less than the rate of flow of prices.

(4) That production is almost entirely initiated by loan credit, and that this loan credit is issued by the banks, and to a very large extent repaid without producing payments to the public in the form of purchasing-power.

(5) That the price level can be lowered by an issue of credit to the consumer.

(1) *Is there an inherent Deficiency of Purchasing-power?*

In examining the various forms of wealth, and the nature and functions of the money which distributes it, we found that the price of an article is its total cost, and the cost is built up of all the payments made on its account either in the form of rent, interest, profit, or wages.

If we examine all the processes by which any particular article is produced, we shall find this holds good. The owner receives the rent of his land; the labourer is paid for his labour; the farmer receives his profit; the miller is paid for his labour and profit, and the baker is similarly recompensed.

When the final consumer buys his loaf of bread he is paying, in its price, the proportion of all these charges which has been incurred in respect of the loaf.

The process by which all the payments, leading up to the final payment by the consumer, are made is that they are drawn from capital, or money in stock, and repaid to capital when the consumer makes his payment. If I buy a motor-car, the price which I pay contains the manufacturer's profit, plus all his costs, and these include the correct proportion of the costs incurred by all other organisations which have contributed to the production of the car. The manufacturer is credited with the total amount, and he uses it, partly to pay the wages of his workpeople, partly in payments for raw materials, and partly to meet his overhead charges, and his depreciation of plant, machinery, and buildings.

In short, the price which I pay for the car represents my payment of all the costs incurred on my behalf, and each organisation contributing to its production gets its right proportion of the total payment. The items which Major Douglas calls "B" costs in the case of the motor-car manufacturer become, in fact, either wholly or in part, "A" costs when they reach the other organisations.

The producer of semi-manufactures uses the proceeds of his sales to produce more semi-manufactures, and in the process pays part of the money to his employees and to his shareholders, and hands the balance over to other organisations. He also has his "B" costs, but only a reduced amount appears in them in respect of my car because by this time it

has repaid the labour costs incurred on account of the semi-manufactures as well as the final manufacture.

When the raw material producer receives his portion of the price of my car, he too makes his payments to individuals, and although he may also distribute sums to other organisations, these organisations in turn will pay for the labour they employ, and will distribute their profits and dividends to individuals. In the end, by whatever channels, and through however many hands, the whole of the sum which I paid for my car will have been distributed to individuals in the form of wages, salaries, profits, interest, or rent.

The fact that the transfers of money from one organisation to another are made through the bank does not at all affect this result. The manufacturer uses the banker's services as a matter of convenience, and at each transfer the money is only paid into the bank in order that it may be drawn out again and disbursed. There can be no doubt whatever—if a little careful thought is given to the matter—that every fraction of the cost of any final product is distributed to individuals and may be used, at the discretion of the recipient, either for the consumption of final products, or for the purchase of capital goods.

It has seemed necessary to stress this fact, even to the point of over-emphasis, because it is critical to Major Douglas' case. If he cannot prove the existence of a gap, his case collapses and he has no argument left which can protect his method from the charge of inflation. The necessity for exhaustive

exploration of the point is greater because Major Douglas is inclined to speak with two voices respecting it.

In *Economical Democracy*, page 59, he says :

> "But it is clear that the total amount distributed in wages, salaries, and profit or dividends, would be less by a considerable sum (representing purchases on factory account) than the total selling price of the product, and if this is true in one factory it must be true in all. Consequently, the total amount of money liberated by manufacturing processes of this nature is clearly less than the total selling price of the product."

Then it will be remembered that in replying to Mr. Keynes (question 4477) he says :

> "All the payments under Group B are purchasing-power, which, if it was obtained by re-investment, was originally in the hands of the public and never gets back into the hands of the public at all."

It is not quite clear why he should have felt it necessary to qualify the claim here by the words, "if it was obtained by re-investment," for, as we found in discussing this particular question and answer, no such limitation is possible. Whatever circumstances may influence the ultimate disposal of "B" payments, the source from which the money was obtained by the debtor is not one of these circumstances.

Yet it may be claimed that Major Douglas himself recognises that at some period of time these payments must have been made to individuals, for in *Credit Power and Democracy*, pages 24 and 25, he says :

> " In considering the above arguments, let not the patient reader allow himself to become confused by the fact that B has at some previous time been represented by payments of wages, salaries, and dividends. While this is of course true, it is quite irrelevant—it is the rate of flow which is vital. The whole economic system is in ceaseless motion—purchasing-power is constantly flowing back from individuals into the credit system from whence it came, and if the outflow is less than the inflow, someone has to lose purchasing-power."

Now Major Douglas' intention here was undoubtedly to meet and overcome the objection that every " B " payment is at some point a distribution of purchasing-power. But does he succeed in overcoming the objection ?

The crux of his whole argument lies in the concluding words, " if the outflow is less than the inflow, someone has to lose purchasing-power." But how has he shown that the outflow is less than the inflow ?

He has to admit that " B " payments are at some period purchasing-power, and he tries to escape from this difficulty by a reference to the " rate of flow." Yet if all " B " payments are at some time in the hands of the public there can be no difference

in the long run between the volume of purchasing-power and the volume of prices.

It is, of course, true that some industrial organisations habitually distribute purchasing-power a considerable time ahead of production ; others a short time ahead ; and others at or about the time of production ; but since this arrangement is continuous, the rate of flow need not be affected. What Major Douglas appears to overlook is the fact that all the organisations which are receiving "B" payments are at the moment paying out purchasing-power to individuals, and that this purchasing-power, distributed in respect of future production, is sufficient to enable the public to buy the goods produced now.

There were, in fact, two alternatives open to Major Douglas. He might have reviewed a complete series of industrial processes, commencing with the production of the raw materials, and ending with the manufacture of the final products, without regard to the time over which those processes were spaced. On the other hand, he might have chosen to take a period of time and ascertain the amount of purchasing-power distributed to the public during that period.

By either of these methods he would have discovered that the total volume of purchasing-power distributed tends to equal the price of all final products. By tracing through the various processes concerned in production, he would see the actual costs distributed to individuals ; by examining any period of time, he would see purchasing-power distributed, on account of future production, to people engaged

in every one of these processes, and the total amount distributed would be approximately equal to the prices of all goods placed on the market in the same period. (See diagram number 1.)

Major Douglas adopts neither of these methods. He admits that the " B " costs have at some time been distributed to the public, but he argues that they have long since been spent. This is, of course, true, but it is equally true that just as these sums were spent in advance of production, other similar sums are, at the moment, also being distributed in advance, and are able to take their place.

When he speaks of the outflow being less than the inflow, he is disallowing, quite reasonably, the purchasing-power distributed in advance and consequently already spent ; but he is also disallowing, quite *unreasonably*, the advance payments which are now available for spending. What he does, in fact, amounts to this : he recognises that production is a continuous process when he is looking backward, but assumes an abrupt termination when he is looking forward.

The process that he visualises is one in which " B " payments are distributed in advance of production, and are lost to the public because they are negatived by a rise in prices. If it were reasonable to consider only this side of the question one might conclude, as Major Douglas apparently does, that production is a continual process of supplying the public with money in advance of production, and taking it back in increased prices.

That such a view is entirely wrong will be seen if it is considered that it implies a break in the

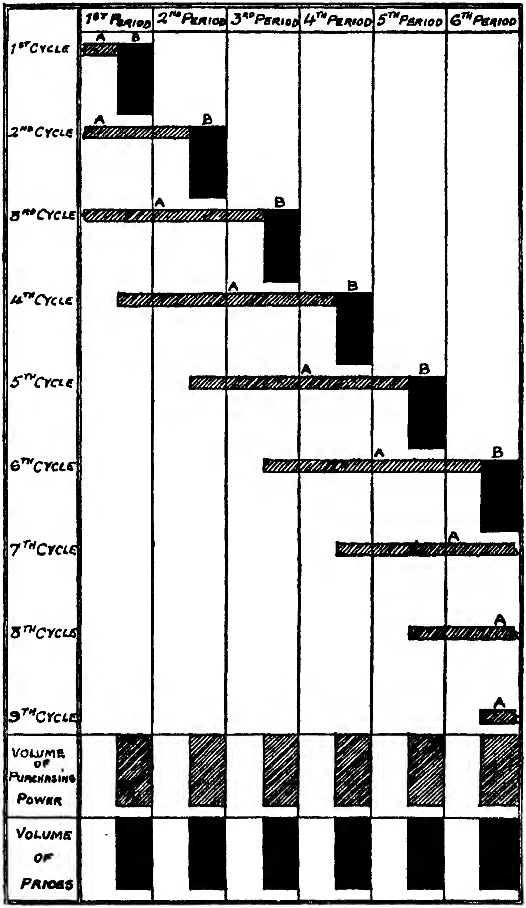
continuity of production, for so long as production continues to be dynamic there will always be purchasing-power distributed in advance, to balance the advance payments which have already been spent. Only by assuming the discontinuance of this process, or by proving a contraction of production instead of the normal expansion, could Major Douglas show the outflow to the public to be less than the inflow to the banks.

This fact is illustrated in diagrams numbered 1 and 2. Number 1 reflects the continuity which is the real feature of production, and shows purchasing-power to equal prices in any one period.

Number 2 attempts to show the shortage of purchasing-power which Major Douglas alleges, but only as a result of presenting production as a periodic process instead of a continuous one.

The object of this second diagram is to demonstrate that, since all costs of production are at some period distributed in the form of purchasing-power—a fact that Major Douglas recognises—it is not possible to show a deficiency of purchasing-power without sacrificing the continuity which is the distinguishing feature of production. The assumption, which has to be made on this hypothesis, that there is an interval between each cycle of production during which no deliveries of final products are made, obviously bears no relation to the true facts. Yet only by postulating some such break in the continuity of production and delivery of goods could Major Douglas support his contention that the flow of purchasing-power is less than the flow of prices.

DIAGRAM NUMBER 1

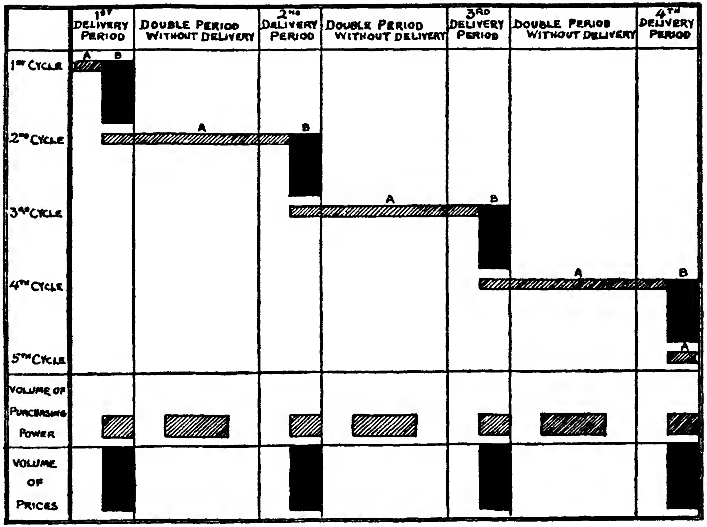


CONTINUOUS PRODUCTION

'A' REPRESENTS DISTRIBUTION OF PURCHASING POWER.
'B' REPRESENTS DELIVERY OF GOODS.

Ns

Diagram Number 2



Periodic Production

"A" Represents Distribution of Purchasing Power. "B" Represents Delivery of Goods

Of course, whenever production is expanding, it may follow that the purchaser holds an increased amount of money some time before the increased supply of goods come on to the market. In consequence, prices tend to rise, and the purchaser gains no immediate advantage. At a later stage, however, the additional goods become available, and just as the increase in the amount of money without an increase in the volume of goods raised prices, so the subsequent increase in the quantity of goods, without a further increase in the amount of money, tends to lower prices. The public will then be getting, what obviously it could not get before the goods were produced, an advantage from the larger amount of purchasing-power.

In the long run, an increase in the volume of production enables the public, if it so desires, to consume the larger volume of goods. If it is accompanied by an equivalent increase of money, the additional goods can be purchased, at the same price, with the new money; but, if the total amount of money is not increased, the larger volume of goods can be bought at a lower price with the same amount of money.

This result is not invalidated by the fact that many holders of purchasing-power may not wish to use it for the purpose of consuming goods. If the amount of money saved for investment is larger than can be profitably accommodated at home, the result may be a surplus of exports over imports as the physical representative of investments which are made abroad. In such a case there might be said to be a surplus of goods for which no market exists at

home; yet the lack of demand would not arise from any real deficiency of purchasing-power, but simply from the fact that the holders of the purchasing-power did not wish to use it for the purchase of consumable goods.

Perhaps some apology is needed for a rather prolonged consideration of this point, but the excuse must be that it concerns the most vital part of Major Douglas' theory, and experience has shown that, like the Hydra, on which ten heads appeared for every one removed, a Douglas fallacy may be presented in many different forms.

(2) *Can Consumers' Credits be issued in such a form as not to produce Inflation?*

The answer to the first contention which we have just been discussing, involves the answer to this second proposition. If the gap claimed by Major Douglas is non-existent, his Consumers' Credits will obviously dilute the purchasing-power already distributed, and produce inflation.

The fact is that the cost of every article which the consumer buys is simply the sum of all amounts which have been, or will be, distributed in respect of its production; and since the flow of payments from every productive organisation is reasonably regular and continuous, the total volume is evenly distributed over every period. It follows that each period must contain its appropriate amount of purchasing-power, although the payments made to the public in the form of wages, salaries, and dividends will for the most part have no direct reference to the goods available for sale in that period. Any further issue

of purchasing-power must therefore be additional to the original cost, and will tend to increase such cost by its amount.

In other words, total prices must equal total purchasing-power distributed during production, and if the latter is supplemented by an amount of purchasing-power which has never appeared in prices, it must be added to prices in order to preserve the correct relation. In all cases of inflation this is what happens in the long run. The dilution of purchasing-power might, in the first instance, catch industry unawares, to the extent that some articles might be bought at the old price with the diluted money ; but the tendency would be for prices to adjust themselves quickly to the greater volume of money, and if further dilution was anticipated, or feared, prices would most certainly rise in advance against the anticipated inflation.

There are three arguments, each of them fallacious, by which Major Douglas attempts to combat the suggestion of inflation.

In the first place, he maintains that the effect of providing the public with the means to purchase more goods will be to stimulate production, and so increase the real wealth of the country. Secondly, he claims that his method succeeds in lowering the price level, and if the method operates so as to lower the price level, it cannot produce the effect of inflation, which is to raise prices. Thirdly, he suggests—although he makes no attempt to demonstrate the point—that the Consumers' Credits which he proposes to issue would not be cumulative but would be self-liquidating.

The first claim is sufficiently answered by the fact that, whatever the volume of production, the goods produced must contain in their price every item of cost, and this cost must reflect any prior increase in the volume of money. It is possible, of course, to defend inflation as a stimulant in some circumstances, but it is none the less inflation, although, within very definite limits, it may be justified.

Where Major Douglas is in error is in supposing that it ceases to be inflation by his method, and may consequently be practised, not as an occasional and rather dangerous stimulant, but as a normal and continuous practice.

The other two arguments to which reference has been made merely reproduce propositions 4 and 5, and will accordingly be dealt with under those heads.

(3) *Is the Rate of Flow of Purchasing-power much less than the Rate of Flow of Prices ?*

The claim which Major Douglas makes here, very definitely and insistently, has already been discussed at some length, and we found it to be completely untenable. The matter may be determined by a very simple logical deduction to which assent will readily be given.

This is the position as Major Douglas sees it. The "B" payments which he considers are not now available as purchasing-power have, he admits, at some previous time been distributed as wages, salaries, dividends, and profits. This must mean that all costs of production are at some time handed to individuals as purchasing-power, and it follows that the total volume of such payments to individuals,

regardless of time, cannot be less than the total of all costs.

This being so, it is impossible for the rate of flow of purchasing-power to be continuously less than the rate of flow of prices. There might conceivably be an irregularity of flow, but this would only mean that any deficiency at one point must be compensated by a surplus at another point.

There is, however, no reason to believe such an irregularity exists, and, on the contrary, every reason for believing that the distribution of wages, salaries, interest, and profits is sufficiently regular and continuous to ensure the same rate of flow, because, for every advance payment which has already been spent, another advance payment is available to take its place.

The process indicated in diagram number 1 is therefore a true reflection of the actual facts, and correctly illustrates the necessary correspondence between money distributed as purchasing-power and prices.

(4) *Is Production almost entirely initiated by Loan Credit, issued by the Banks and to a large extent repaid, without resulting in Payments to the Public in the form of Purchasing-power?*

Whenever Major Douglas is discussing his proposal for the issue of Consumers' Credits he obviously has, at the back of his mind, the belief that they would not be cumulative, but would automatically drop out of existence after having served the purpose for which they were created. His firm conviction that his process differs from merely putting more money

into people's pockets, and so producing inflation, appears to rest on the belief that he is giving the consumer, not money which must influence all future prices, but a credit which is only intended to serve one particular purpose, and will have only a transitory existence.

The reader will recollect that on several occasions during his evidence before the Macmillan Committee, Major Douglas plainly indicated that this was his view.

For example, when Mr. Brand asked, "How would the credit be repaid?" he replied, "The repayment is involved in the price of the goods."

Again, in reply to Mr. Tulloch's question, "That involves a large creation of credit, does it not?" he said, "It does not involve any larger creation of credit than at the present time, because the result is to lower prices."

When Sir Thomas Allen, referring to the payment of interest on the credits—which Major Douglas had admitted—asked, "Would it be a charge in perpetuity?" he replied, "No, it would be extinguished by the sale of the goods."

Later, in replying to a question put by Professor Gregory, he said, "Now, the whole of the price which is collected from the public becomes an item for cancellation, just as it does at the present time."

Altogether, Major Douglas leaves no room for doubt that he views bank credit as a shadowy substitute for money, which the banks are permitted to create to a practically unlimited extent, and which they are equally able to cancel whenever they so desire.

The fact is, however, as we have seen in the previous chapter, that bank credit is money, which, as soon as it is created, is indistinguishable from that already in existence, and has the same right, which all other money has, to be represented by physical money. We saw, too, that the banks have no unlimited power to create this money, but can only bring it into existence when the necessary permissive action is taken by the Central Bank.

It follows, therefore, that they are no more free to cancel credit, *of their own initiative*, than they are to create it. A Joint Stock Bank, having created money on the basis of its cash, lends this money to its customers, and only when the loans are repaid can it destroy the money, or re-issue it, according to the state of its cash.

But the Consumers' Credits which Major Douglas would issue would be given to the consumer and would never be repaid. Consequently the banks would be in the position of having issued money to individuals from whom they would never receive it back, and when the credits returned to the banks they would return as deposits, for which the banks would be responsible to the depositors, and which they could not therefore cancel.

Since Major Douglas' conception of the nature of bank credit is entirely erroneous, it cannot give the support which is necessary to his theory of a gap between purchasing-power and prices, which might be filled by Consumers' Credits. Such a theory implies the existence of an adjusting factor which is so elastic that it can bridge a constantly recurring gap by a direct financial adjustment between the

productive system and the banks, and may just as easily make the same adjustment by including the consumer in the circuit.

(5) *Can the Price Level be lowered by an Issue of Credit to the Consumer?*

The claim which Major Douglas makes here is so extraordinary, and so entirely illogical, that it is difficult to believe him altogether serious. That any addition to the total volume of money merely dilutes its value in relation to a given quantity of goods is one of the most elementary facts of economics, and the author of the theory of Social Credit appears to be fully aware of it when he says that simply to put more money into people's pockets would defeat the end in view by raising prices.

What is extraordinary is that he should think to escape from this dilemma by making the claim that the effect of his method is to lower the price level. It seems almost incredible that he should have ignored the obvious and elementary fact that you can only lower the price level by *reducing the amount which the producer receives*.

There are, in fact, two ways of making the adjustment which Major Douglas contemplates. One is by operating at the producer's end and lowering prices, and the other is by giving a subsidy to the consumer and disregarding prices. In other words, he could adjust prices so as to bring them into relation with purchasing-power, or alternatively he could adjust purchasing-power in order to make it equal to prices.

The first method, if it could be achieved without

reducing the volume of money in circulation, would undoubtedly benefit the consumer, but it would be at the expense of the producer, who would be getting a smaller return for his goods and services. The second method, which is the one which Major Douglas proposes, would provide the consumer with a subsidy to enable him to purchase at the full price ; yet in this case, just as much as in the first, the advantage given to the consumer would be given at someone's expense.

In the case of a subsidy raised by taxation, the cost would be paid by the particular section of the public who paid the new taxes. On the other hand, if it was provided out of credit, the consuming public would be in the position of paying for their own subsidy by an indirect method.

When Major Douglas proposes to subsidise the consumer out of credit, in order to enable him to purchase goods at less than cost, he is placing on his shoulders a liability to pay for that subsidy in increased prices in the future. But this is not all, for immediately the holders of goods for sale became aware of the intention to distribute new money to purchasers, they would realise that the payments they were to receive for their goods would be made in the diluted money. They would naturally try to protect themselves against loss of their profit through a fall in the value of money, and prices would rise against the consumer at the outset.

In consequence, the public would probably have to pay away the increased amount of money for the same quantity of goods and, without having gained any advantage, would be faced with a higher price

level and forced to agitate for higher wages and salaries in order to restore the position which existed before the credits were issued.

The claim that Consumers' Credits would lower the price level is therefore a travesty of the facts. They would most certainly raise future prices above the level at which they would have stood without the additional money, and would almost certainly raise the prices of the particular goods which they were supposed to assist the consumer to buy.

This particular claim, which Major Douglas repeatedly made in the course of his evidence to the Macmillan Committee, is alone sufficient to discredit his theory, for it is completely lacking in any logical justification. Yet, in spite of the fact that it is clearly impossible to lower the price level without reducing the payment which the producer receives, advocates of Social Credit are constantly advancing the argument that to supply the purchaser with part of the purchase price is the same as to reduce prices.

The fact that the method by which the subsidy is provided must inevitably raise the price level does not lead Major Douglas and his supporters to doubt the validity of the argument. One can only assume that they are misled, by a false conception of bank credit, into believing that a Consumers' Credit would not be money but merely a cypher which could not influence prices, although, curiously enough, it is assumed that it would be sufficiently substantial to satisfy the producer.

Finally, there is what may be termed a common-sense argument against Major Douglas' proposals,

which may perhaps carry more weight with some readers than the analytical method, which of necessity becomes rather protracted. It is the argument that, while the machinery of production is owned and controlled by individuals or groups of individuals, the whole of the product becomes, as soon as it is produced, and remains until it is sold, the sole property of the owners of the productive machinery.

This ownership gives the producer the power to fix the prices of the goods he offers for sale. Normally, the minimum return which he requires to induce him to continue to produce is an amount which will enable him to cover his costs and collect his own profit, and the nominal amount of this price has a very definite relation to the amount of money in circulation.

However the claims on goods are distributed, and in spite of the fact that some holders of claims do not wish to use them for the purpose of consuming goods, the fact remains that existing prices reflect the existing claims, and if Major Douglas introduces additional claims on the same goods he cannot prevent the holders from advancing prices to the same extent that he dilutes the purchasing medium.

His method fails, therefore, because it has no control over prices, and because the owner of the means of production, who does control them, is bound to exercise his right to increase the price at his end whenever Major Douglas reduces the value of money by diluting purchasing-power at the consumer's end. To imagine that the producer, having fixed

the price of his goods in relation to existing claims, will allow those claims to be increased indefinitely without revising his price is an illusion which no serious student of economics would for a single moment entertain.

CHAPTER VII

CONSTRUCTIVE

THE OBJECT of the foregoing pages has been to demonstrate the fact that the Social Credit scheme which Major Douglas propounds is unsound in theory and unworkable in practice. Yet it would be foolish to deny that in part at least his criticism of the present economic system is justified.

His proposals would never have obtained the measure of prominence which they have secured, were it not that they profess to provide the cure for defects which undoubtedly exist. It cannot be too clearly stated that the rejection of his particular remedy does not imply that no remedy is needed.

It is sometimes possible to agree with Major Douglas in his diagnosis, although it would be extremely dangerous to follow his prescription. Merely to condemn his proposals, without recognising that his propaganda has helped to focus public attention upon the need for economic and monetary reform, would be both unfair and unwise. It is proposed therefore, in the concluding section of the present volume, to indicate the defects which exist, and to suggest appropriate remedies.

Probably the advocates of Social Credit owe much of the support which they have received to a widely

distributed, though often rather hazy, recognition of the fact that, while the potential supply of goods greatly exceeds the present effective demand, vast real needs remain unsatisfied. Whilst we are experiencing serious difficulty in distributing and consuming the goods which are produced, we realise, with some uneasiness, that we could produce much more, and at the same time most of us would like to consume much more.

Only the most determined obscurantism would attempt to deny that there is something radically wrong with a system which encourages sabotage in order to create a scarcity, and dreads a glut as though it were a plague. There is assuredly a problem here to be solved, although Major Douglas' method of solving it has to be rejected.

We have seen that the truth is that purchasing-power has been distributed against every item of cost, and this purchasing-power is available to buy the goods which are offered for consumption, *if the holders wish to use it for the purpose of consumption.* That they do not so wish is due to maldistribution.

The present profit system means, inevitably, that the savings for investment are greater than are necessary to replace wastage of plant and machinery. With a fairer distribution of the product, consumption would have first consideration, and only after all needs had been fully met would a proportion of the surplus over actual needs be allocated to an expansion of future production.

An individual holding purchasing-power consumes what he needs, and saves out of the margin beyond his necessities, and the community as a whole

ought to act in precisely the same way. Yet the present unequal distribution of the national product frequently means that the margin for some individuals is so large that the saving is effected at the cost of restricting necessary consumption at the other end of the social scale.

The objection that such savings are redistributed in the form of wages and salaries in respect of further production does not meet the point, because the same maldistribution persists with each distribution of purchasing-power. There is, in consequence, a continual tendency to overweight capital production, and a chronic holding up of consumption.

Such a system requires a permanent and unrestricted outlet for the investment of savings, but the fact that such savings are overweighted, and the purchasing-power available for the home market proportionately restricted, results in a surplus of unsold goods and acts as a deterrent to further production. The only remaining outlet is foreign investment, and so long as other countries, less developed industrially than our own, were willing to borrow our surplus capital, and take payment in our surplus goods, the system worked with an appearance of great prosperity and efficiency. The home market never absorbed the share it should have had of increased production, and the surplus was lent abroad, to build up our vast foreign investments.

But Nemesis is rapidly overtaking this system, for each foreign nation in turn is ambitious of becoming industrialised, and is not only supplying its own needs, but is competing for a share of the remaining markets. In consequence the outlet becomes

continually smaller, and either markets remain over-stocked with the goods which the holders of purchasing-power do not wish to consume, but cannot lend, or prices are forced down to unprofitable levels.

However unpalatable it may be, we shall sooner or later have to face up to the fact that the exploitation of foreign markets was simply a passing phase, and that we are rapidly approaching the time—if we have not already reached it—when no nation can expect to do more than balance its imports with exports. When this is definitely realised, the development of the home market will become an all-important consideration, because it will need to accommodate the equivalent of the total national production.

Productive capacity will not expand in consequence of new discoveries and inventions, and improvements in process, unless consumption keeps pace with production. The decline of export trade makes this impossible unless the national income is distributed so as to permit the whole product, or its equivalent, to be consumed at home without undue delay.

If we will not learn by a process of reasoning, we shall in the end be taught by bitter experience, that great accumulations of wealth, existing side by side with want and scarcity, only produce a disequilibrium between production and consumption which will, in the end, destroy the system which permits it.

Over three hundred years ago, Francis Bacon wrote that " money, like manure, does no good till it is spread," and the world to-day is far from

realising and acting upon the wisdom contained in these words. We have allowed the acquisitive instinct to get out of all bounds, and have permitted the accumulation, by individuals, of demands on goods to reach such proportions that money is piled up in great heaps instead of being spread.

The control by individuals, or comparatively small groups of individuals, of vast accumulations of wealth, implying, as it does, the control of the means of production upon which the whole community depends, is antisocial and unjust.

The means of satisfying all the needs and desires of mankind have been built up out of the labour and research and self-sacrifice of generations of people who have worked and striven and left behind them additions to the store of knowledge. The common heritage they left belongs of right, not to a privileged class, but to the community as a whole.

Sooner or later we shall recognise the wisdom of at least securing this heritage for posterity, for if we ourselves choose to remain in chains, we have no right to condemn posterity to an increasing bondage. If we fail to free them, a generation will arise which will refuse to allow their lives to be controlled and restricted in order that the principle of private profit shall remain unimpaired.

How may we achieve this freedom?

One means lies to our hand. We have become accustomed to the practice by which the State collects in Death Duties a portion of the estate of its more wealthy citizens. There is no reason why this practice should not be extended so as to reduce still further the greater accumulations of wealth, and so

long as an opportunity was left for making reasonable provision for dependants, there could be no real injustice.

If a member of the community is allowed, within the limits of the law, to accumulate wealth and use it for his own advantage and enjoyment, he can only do so because of the protection which society affords him and by virtue of the common heritage of knowledge placed at his disposal. It is surely not unreasonable, therefore, to claim that, when he can no longer use that wealth, and after he has been allowed to make provision for his dependants, it should return to the common stock from which it was drawn.

But when it returns, it should return as a part of the community's capital, and not as an addition to its income. The practice of using the proceeds of Death Duties to meet current expenditure is altogether wrong, for if it is bad finance for an individual to deplete his capital in order to supplement his income, it is equally bad finance for the State to do it on behalf of individuals. The yield of Death Duties should therefore be treated as national capital and applied, first to the liquidation of debt, and then to the building up of a capital fund.

In this way the State, without purchase and without expropriation, would gradually regain possession of assets which have been built up by the community, and on which the life of the community depends. The rate at which the restitution would be made would depend upon the will of the people and, if they so willed it, could be completed within the lifetime of a generation.

Private property would in the end consist only of consumable goods. Individuals would still own whatever they had acquired for their own consumption, but all capital goods—all the means of production and exchange—would be owned collectively and administered on behalf of the community.

Of course there would be difficulties—any great scheme of social reform must present difficulties; but if the principle is sound a method of applying it can be found.

The fact which we have to face is that the development of backward areas cannot for ever be relied on to absorb the unnatural surplus which the profit system creates. In the long run we must find some method of distributing claims on all consumable goods to people who really desire to consume them.

The present profit system results in a maldistribution which leaves the bulk of the community short of goods, in order that a few may have more than they can consume, and, until the few can dispose of their surplus by lending it, production is retarded, and the whole community suffers. If we could find some new accessible planet which offered unlimited opportunities of development, the immediate difficulty might be removed. Industry could then continue on a profit-making basis so long as this new outlet was able to absorb our surplus goods quickly enough to allow production to proceed continuously and keep the whole of our industrial workers employed.

But no such solution is likely to present itself. The world is organised to produce on a scale far greater than its present production, but it cannot consume the goods which are produced, not because it does

not need them, but because it has created a fictitious surplus which it must first lend.

To add to its troubles it is constantly discovering methods of producing more, and still more, goods, with the same expenditure of labour, but as it cannot distribute and consume these additional goods, it can only displace labour. Purchasing-power is consequently reduced at the point where it would be most effective, since wages and salaries are for the most part used for immediate consumption.

The remedy is for the community to own and control the means of production, and to produce for use instead of for profit. All the resources of science and invention could then be utilised to expand to the utmost the productive capacity of the nation ; the means of acquiring and consuming the product could be distributed in the form of wages and salaries, and possibly some form of national dividend—distributed over the whole community—might take the place of profits and interest. When the real limit of consumption had been reached, technological advance could be applied to reducing hours of labour and increasing leisure.

Under this system the product would belong to the community at the outset, and in consequence it could be distributed by whatever method was desired. On the other hand, so long as private individuals are left, as at present, to produce and sell for their own profit, no manipulation of the currency will overcome their right to fix the price at a level which is profitable to themselves. So long, in fact, as the product has to be acquired from the owners of the productive machinery, it must be

acquired at a price which will cover all costs plus profit. Only by securing the ownership of the means of production can the community obtain the right to distribute the product by any method which may be socially desirable.

An essential accompaniment of a reformed economic system would be that the State should have complete control of finance and currency, and in its final form there would be no private profit in banking any more than in the other departments of economic life. But progress toward this end might be slow if the necessary public sanction was given gradually, and there would in that case be a considerable period during which the old system would persist side by side with the new.

Effective control of monetary policy would, however, be necessary from the commencement, and this could be secured by State control of the Central Bank, even though the Joint Stock Banks remained, for the time being, under private ownership.

As we have seen, the Central Bank can and does govern the policy of its customers the Joint Stock Banks, by its Open Market Operations, and through its power to determine—and to vary from time to time—the Bank Rate. In addition, a nationalised Central Bank could use its power of regulating the supply of money for the purpose of stabilising prices at the level found to be most desirable.

The particular method of achieving this result might be the price index method, and if the index was built upon a scientific evaluation of all the relevant factors, it could be made to reflect, with

reasonable accuracy, the general purchasing-power of the currency.

It is clear, therefore, that the Government could, by exercising control over the Central Bank, preserve a stable currency and be the real director of financial policy. Yet there would remain a very definite disadvantage—a disadvantage to which reference has already been made.

If the powers of credit creation which the banks now possess remained unimpaired, every increase in the volume of money would—to the extent of nine-tenths of its amount—be handed over to the banks as a profit-making asset. Such a process is both unnecessary and inequitable.

It is unnecessary, because the required addition to the currency could just as easily be made by the Central Bank; it is inequitable, because the creation of new money, to be the financial representative of the physical wealth which the community has created, ought to be the inalienable right of the people and not the privilege of a corporation or a group.

There is no valid reason why the Central Bank, acting for the community, should not issue in full whatever additional money was from time to time required, so long as steps were taken to prevent the Joint Stock Banks from enlarging their credit in respect of the new money. This could be done by regulating by statute the proportion of cash to deposits which they would be required to keep.

At the present time they voluntarily work to a proportion of about 11 per cent, and if it became necessary to increase the volume of money, the

proportion might be fixed by the Central Bank—under legal powers given it by the legislature—at say 12 per cent. The money necessary to meet the increased cash requirements of the Joint Stock Banks could at the same time be issued by the Central Bank, together with whatever further sum was needed to enable them to increase their earnings sufficiently to cover their additional interest liabilities to depositors.

For example, if on the basis of £2,000 millions of deposits the proportion was raised to 12 per cent, the banks would need an additional £20 millions of cash. If, however, the Central Bank issued £23 millions, the Joint Stock Banks would be enabled to extend their credit in respect of the £3 millions surplus by a further £25 millions. They would, consequently, be receiving £23 millions of additional cash, for the use of which they would be liable to pay their depositors, and at the same time their lending capacity would be increased by £25 millions.

The banks, by such an arrangement, would be in a position to make their legitimate banking profit by buying the use of money from depositors, and selling the use of it again to borrowers. They would not be presented—at the expense of the community—with an additional lending capacity for which they paid nothing, but which they could employ for the purpose of profit earning; they would merely be enabled to carry out the ordinary banking function of borrowing in order to lend, and the fact that their lending capacity was increased at least to the same extent as the increase in their liabilities to

depositors would ensure that their legitimate interests were safeguarded.

They could not, as bankers, object to an increase in their business which brought them an added profit on the use of the money deposited with them, and there is no reason why the community should rob itself of an asset in order to inflate an already sufficient profit.

There is a further criticism which may justly be levelled at the practice of leaving the creation of credit in the hands of the Joint Stock Banks. Of necessity, credit so created must be mainly used for capital production, and it follows that purchasing-power already required for the consumption of an existing surplus of final products can only be supplied by broadening the basis of production and so creating a further surplus.

The real motive for an increase in the credit basis is the provision of additional purchasing-power ; yet the present arrangement involves that it may only be supplied by a process which automatically increases the demand for purchasing-power.

In so far as Major Douglas contends that an expansion of credit—made necessary by increased production—only becomes available for the purchase of final products after it has filtered down through additional capital expenditure, and in the process has created a new insufficiency of effective purchasing-power, there is a good deal of substance in his claim.

There can be no doubt that normally the need for currency expansion arises directly out of an

increase in the supply of final products relative to the amount of money available to purchase them. Such an increase may be allowed to lower prices, or can be equated by an increase in money of sufficient volume to keep prices stable.

But clearly, if the latter method is to be really effective, the additional money ought to be applied as purchasing-power at the outset, and not forced through a process which, at the same time, is being hindered and constricted by the resulting delay in the consumption of goods.

Yet the present method involves that there will always be a lag between increased production and increased purchasing-power in the hands of consumers, and the existence of the lag creates an obstacle in the way of overcoming the deficiency. For when the goods are actually on the market, the consumer, who would willingly buy, has to wait until more goods are produced before he can obtain the necessary purchasing-power, and it is more difficult for him to obtain it because the existence of the unsold surplus is a discouragement of further capital production.

The position really amounts to this. When people require more money with which to buy a greater volume of goods, the banks—which have the monopoly of issuing the new money—cannot issue it as spending-power to consumers, although its real object is to enable the consumers to buy. All they can do is to permit someone to employ the additional money as capital in the first place, so that the consumer may get it as income in the second place.

Now if the mechanism was such that the consumer got his increase in income at the commencement, there would be no unnecessary lag acting as a check on the whole process, and expansion of capital production would not be imposed as a condition of monetary expansion, but would follow naturally from saving. In other words, additional spending capacity would be provided whenever necessary, and additional productive capacity would be allowed to accrue naturally, except that if and when the ownership of the whole productive machinery became vested in the State, employment could be allocated between capital production and the manufacture of final products as circumstances dictated.

The method by which monetary expansion could be operated from the consumer's end is simplicity itself. Given State control of the Central Bank, and given the power to regulate the proportion of cash to deposits maintained by the Joint Stock Banks, the process would be as follows.

Whenever the Central Bank decided—either in consequence of an actual fall in the price index, or because its information indicated the imminence of such a fall—that an expansion of currency was called for, it would place the required amount to the credit of the Government, at the same time calculating the new proportion arising from the increased volume of cash, and publishing it for the information of, and observance by, the Joint Stock Banks.

The Government would be able to draw upon its credit to meet its various commitments, and by the

extent to which government payments were financed from this source, the consumer would be relieved of either direct or indirect taxation. The national income available for the consumption of final products would, in consequence, be increased by the amount of new money issued, and the consumer would have the means of acquiring whatever volume of goods was, from time to time, available for consumption. The lag would thus disappear, and no obstacle would be placed in the way of expansion wherever it was made possible by technological improvement, or whenever it was provided for by saving on the part of individuals or of the State.

Whatever form the approach may finally take, some movement toward Social Ownership appears to be clearly indicated. The centralising effect of economic and ethical progress is continually concentrating power. The individual seems destined progressively to lose control of the forces which govern his life and well-being, and become more and more dependent on large-scale organisation.

Whether or not the danger point has already been reached, there undoubtedly is a danger point beyond which power cannot safely be left in the hands of individuals or small groups of individuals, and the community must, in self-defence, recover control of forces which are vital to its existence.

Major Douglas' Social Credit proposals fail because they leave private ownership in possession of the means of production and exchange, and in possession therefore of the power to neutralise whatever adjustment his method attempts.

Ownership of the productive machinery will always be the dominating fact. The community, if it is to be free, must control the machine. Alternatively the machine will either cease to function or will enslave the community.